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Discussion Draft

THE BLACK ECONOMY IN INDIA
PROBLEMATIC AND POLICIES

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Problematic and Policies

Contents

Part I: Problematic

Part II: Policies

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INTRODUCTION

The basic purpose of the exercise is to address itself to some conceptual and analytical issues concerning the long standing phenomenon of tax evasion in India and the whole edifice of economic activities and relationships which emerge on this basis. It is a farmore pervasive and serious equivalent of what is known as "moonlighting" or the 'second economy' in many developed market economies. Such an analysis has to go into the question of the working of the emerging black sector and the manner in which it relates itself to the real, circulation and control spheres of the economy. A circuit of interaction of this kind is connected with the entire political economy of India to which a selective and floating reference is made throughout the study in so far as it bears directly on the issues under discussion.

Thus inevitably and consciously we explore a large number of policy issues, including a review of various interventions made so far in order to deal with the distortions, inequities and stagnation generated by the black economy. Though the exercise focusses itself on issues

related to the black economy, the policies discussed and advocated are closely related to the entire range of issues connected with Indian development. The black economy is too pervasive to permit a policy package concerned primarily with itself. It has to be integrally related to the entire political economy of India at the present juncture, keeping in view the relevant historical context.

Apart from a survey of the literature, deductive-logical exploration based on well-known and widely accepted features and facts of the evolution of the Indian economy over nearly past three and a half decades, I have relied on many official reports of various ministeries as well as the report of many expert committees which dealt with issues connected with the black economy in India. But the most useful insight was to rely on a large number of informal, unstructure discussions with a large number of businessmen, chartered accountants, government officials from taxation departments, public men and, of course, academics for arriving at many formulations, analytical points and policy suggestions.

As Schumpeter maintained, any analytical effort is preceded by a pre-analytical cognitive act, visualising a distinct set of coherent phenomenon. Such a Schumpetarian Vision about the phenomenon of the black economy involves cognition of activities, dealings, flows and stocks which are neither 'distinct' nor 'coherent'. The black economy, in the very nature of things, is a very unorthodox subject, where one has to grapple with deliberate falsification of data and returns and with deals taking place in prohibited areas which are zealously guarded secrets. Any attempt to cognise these may take one to many blind alleys, made darker by the rules of official secrecy and multifaceted overt and covert connivance between those who indulge in the black deals and those whose supposed task is to prevent, detect and penalise such acts.

Therefore, many of the formulations are derived from the initial assumptions concerning the nature of the black phenomenon and its possible, a priori mechanics of operation based on the behavioural assumption about the pursuit of self-interest. Obviously, such assumptions cannot be true in every single case - their validity lies in their

of the economic mechanism by incorporating the black sector, broadly coincide. Thus rising capital-output ratias, worsening relationship between savings, investment and growth, increasing improverishment, receding prospects for full employment, distortion of the product-mix against mass consumption goods, helplessness in controlling inflation, declining degree of effectiveness of planning, public policy, controls and regulations, increasing cynicism about the workability of the system, political crises, mounting social tensions, a growing doubt concerning the legitimacy of the system, etc., are very well documented features of the current scenario. Thus one may venture to suggest that current social experiences and practices provide support to for the formulations advanced, apart from their logical consistency.

To those who look for quantitative evidence, it would be difficult to reconcile to such a perspective. To me, for one, the attitude to such issues is better summed up in the words of Paul Baran.

"Neither simple definitions nor refined measurements can be substituted for analytical efforts and rational

basis on the statistical law of large members. It is our discussions with a large number of persons directly and/or indirectly associated with these activities which makes us bold enought to expect the reality to be broadly of the kind assumed in these cases. Moreover, the distortions caused by the black sector qualify in a substantive manner the formal models of the economy which assume away such deviations. It is our belief that incorporating these formulations about the black sector into the analyses of the formal, legal economy enables one to acquire a better understanding of the operational mechanism of the economy, firmly grocending it into the broader context of the polity and society.

These are areas in which it is not possible to stumble upon concrete, statistical evidence for empirical verification of the propositions deductively arrived at. Their justification has to be seen in their confirmity with the *qualitative* operational mechanism of the political economy of Indian development. These formulations assure that the *direction* of the development which actually takes place, and the *direction* of the development inherent in our redefinition

judgement. Yet it would certainly seem desirable to break with the time honoured tradition of academic economics of sacrificing the relevance of the subject matter to the elegance of the analytical methods; it is better to deal imperfectly with what is important then to attain virtuoso skill in the treatment of that which does not matter."
(Paul Baraon, <u>The Political Economy of Growth</u>, Modern Reader, New York, 1957, p.22).

This is neither an apology nor a justification; it is plainly a matter of feasibility. The subject of the black economy needs investigations, analyses and designing of policy-mixes. Lack of data, evidence, earlier theoretical and/or empirical works and analytical methods adequate for the task are no justification for ignoring such a worrysome and menacing problem.

This is no plea for warding off criticisms; all that is implied is that methodological purists should bear in mind the realistic constraints. And they may also bear in mind that for live and applied issues, actual practice and

available alternative schemes of analysis and action too provide touchstones and not so-called empirical verification alone. In sum, it is an attempt to deal with an important subject, notwithstanding the imperfections of the analytical methods, which seem to me to be presently inherent in the subject.

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An Exposition on the Character of the Black Economy

What essentially is the problem of unaccounted money or black money? On account of a large number of factors, income tax and some other taxes are not paid in correct amounts on the whole or part of incomes and on other economic transactions and assets by individuals, businesses and corporations. As a result, the part of incomes, activities, assets etc. on which taxes are not paid becomes unaccounted in the eyes of the law.

These incomes originate in legitimate economic activities. Some of these transactions may not violate any law. But tax-evasion on these incomes and deals deprives them of their further legitimacy.[1] Evasion of many other taxes also produces similar result. Most of such incomes are generally in the nature of abnormally high rates of return or very high professional fees or very high scarcity prices for real estate, and other assets i.e. super capital gains.[2] On the other hand, there are some other varieties of black incomes which arise from illegitimate economic activities like black-

marketing, (i.e., selling goods at higher than controlled or legal prices) and other economic offences like adulteration, smuggling, operation of illegally installed capacities, running underground factories, setting up 'ghost factories' and disposing of scarce, high-premium inputs, whether imported or indigenously procured at 'black' prices, taking fake registrations under sales tax and eating up of tax-revenue so collected, inferior low-cost construction by contractors, under and or over-invoicing for raw-materials, capital goods, other inputs and finished goods,[3] etc. If the first category of black income arises not in the course of an illegal activity but in consequence of the subsequent failure to declare them for tax purposes, for the second category of black incomes, even the sources of origin of such incomes are illegitimate. In this sense, the former may be called simple black income and the latter compound black incomes.[4]

A distinction is often made between a flow of black incomes and a stock of black wealth. The former refers to "income which is earned in the process of evading indirect taxes and/or the part of income, however earned, which is not declared for direct taxes. "(Sundaram K. and Pandit V., "On Black Money," Indian Economic Review, Vol.IX NS,No.2, October 1976, reproduced in Dwivedi, D.N. (ed) Reading in Indian Public Finance Chankya, Delhi, 1981, p.8 142-156).

The latter "arises from the accumulation of the savings out of the black incomes." (Ibid, p.143).

This distinction does not take into account the further investment of the accumulated black savings for generating further black income flows, i.e. compound black incomes.

Thus while at a point of time, there can be a distinction between flows and stocks, overtime it becomes blurred because stocks help generate flows and flows are converted into stocks. Overtime, as the stock of black wealth becomes sizeable, it starts to exert a marked influence on the current flow of black incomes.

Compound black incomes may be classified into two broad groups. There may be activities which are illegal and hidden. Hence incomes obtained in such activities cannot be declared for tax purposes. These activities also include a number of manipulative deals taken up in order to make use of accumulated black incomes and remove accounting incongruities resulting from these. For example, suppose that some property is planned to be acquired for Rs.10 crores, for which Rs. 2 crores are to be paid in 'white' money. Though the buyer may have the

capacity to finance the deal, he may not be in a position to account for the sum. Hence he would take 'fictitious' loan entries from a large number of persons, who will, in consequence, start obtaining regular black incomes. Such 'black' incomes keep moving in an expanded black circuit.

On the other hand, a large number of accounted, legal and open activities carried out by companies, registered firms, partnerships or proprietary firms, for which the values of the transactions are either partially recorded or over-recorded, depending on whichever way the net financial advantage lies and the tax liability is lower. Thus purchases are recorded at a higher price (the difference between the 'correct' and 'inflated' price being shared between the parties to the deal, according to their economic and bargaining strength), underhand premia are collected for sales, fictitious commissions are extorted for dealerships, etc. In the case of installation of plants and machinery (whether for a new firm or for expansion) while the controllers of public limited companies try to 'buy' low and get billed high and pocket the difference personally, private limited companies and proprietary or partnership firms, which may like to plough back their black wealth,

and/or reduce their wealth tax and other tax obligations on the value of investments, may like to get billed for lower sums, paying the difference in cash under the counter.

These second category of transactions with an unaccounted part added to an accounted transaction perhaps are the most common, because they reduce the tax liability of the companies and firms. It is these activities which are the 'links' between the black and the legal sectors turning the actually operating economy a 'grey' one.[5]

However, the distinction cannot be carried too far. There could be cases when abnormally high rates of return are earned by artificially creating scarcities, e.g. through speculative stock-pilling, which may or may not be illegal. But once such super incomes are earned, they are not disclosed for tax purposes. In such cases, the source of earnings may not be exactly illegal, but some manipulative operations may be resorted to for obtaining 'unfair' returns. In fact, basic to all black incomes is the prevalent notion of an acceptable net rate of return which is far in excess of that permitted under the law of the land after taxation. Apart from naive views blaming the black transactions on high tax rates

or extensive controls, it has been suggested that "black income arise from the infeasibility of enforcing direct and indirect taxes in a significant part of the economy comprising of a large number of household enterprises" (Sundaram and Pandit, op.at.p.143) The above are related to "the characteristics of the fiscal environment and of income flows" (Ibid.p.143). The fiscal environment is said to include tax structure, the penalties on evasion, probability of detection, etc. Apart from ignoring widespread tax evasion in non-household, corporate sector, the above view emphasises a proximate factor, viz., infeasibility of tax enforcement without asking questions about the basic economic factors and their relationship with the government in general and tax administration in particular which enable people to successfully evade taxes. It is a wide gulf between the possible and acceptable rates of rewards on the one hand and the legally post-tax permitted rates which impel people to evade taxes and undertake activities which cannot be declared and create linkages with the political system enfeebling tax enforcement. As Albert T. Summers puts it, "wherever there is a real or potential living return, a market system will develop a viable form of doing business." ("Ends and Means: Market versus Government" in Economic Impact, 1980/2, p.72)

It is also possible to think of another type of black income - a variant of the compound variety - which arises from the interaction of the economic and political spheres. Politicians and bureaucrats are bribed by the businessmen for a great many purposes. To an extent, such 'incomes' can also be extorted from the general public. This kind of political administrative black 'incomes' play a role in distorting public economic decision-making far out of proportion to their own quantitative magnitude.

To the extent the black incomes are kept in the form of cash-balanced, they constitute black-money. These incomes in their turn generate a number of cash-flows in the system and hence people come to hold cash balances which they cannot legally account for. If the entire amount of unaccounted incomes earned during a particular year were kept in the form of cash balances, one can say that the unaccounted money generated during the year and unaccounted incomes produced during a year in the system would be equivalent. Thus the popular identification of black income with black money may be true only under some special cases.

However, it is common knowledge that only a part of the unaccounted incomes is generally kept in the form of money. The unaccounted black income is used, like the rest of income, for many different purposes. A number of consumption items are financed out of such incomes. A part of such incomes is also ploughed back in the form of money capital for purchase of merchandise, raw-materials, capital goods and payment of wages and salaries especially through proprietory or partnership firms, agricultural farms and trusts. Or, a part of such earnings is loaned out in a clandestine manner to those who may like to make use of these funds for any of the purposes discussed above. A good part of this income may also be used for buying political patronage and for oiling the wheels of bureaucracy in order either to expedite one's work or to get extra-legal decision made in one's favour. This money income may also be used for building up one's stock of hoarded wealth in the form of jewellery, houses, antiques and such other durable luxury items which add an element of ostentation to one's life style.

The process of conversion of undeclared incomes into black-money, underhand income-yielding assets etc. is greatly facilitated by the existence of a vast unorganised, informal sector, untaxed economic activities like agriculture (even if controlled by persons with substantial non-agricultural interests) and organisational forms like partnerships, unregistered firms and trusts of various kinds. As a result of the above factors, there emerges significant and sizeable linkages between the legal, tax-paying activities and illegal, tax-evading activities. Anyone earning sizeable tax-evaded income for a sufficiently long-period of time would like to use his command over resources to further expand his resources. It means he would make use of his black money in such organised and unorganised sector income-yielding investments which give a good return with not too great a risk of getting detected. Unorganised, informal sector activities, trade, smuggling, services, manufacturing etc. organised as unregistered or partnership firms or undeclared component of organised formal sector units and investments in agriculture (as absentee owners in the case of urban industrial, merchant and professional categories and as leasing-out landlords in the case of rural traders, money-lenders etc.) become the means for self-expansion of black money incomes.

Thus there emerges black incomes, which may be either simple black incomes (i.e.earned through legal means) or compound black incomes (i.e. earned by undertaking illegal activities), but being financed out of earlier black earnings, cannot be brought, at least directly or in a straight forward manner, under the orbit of taxation (let along the question of willingness to do so). Hence these secondary and tertiary rounds of black income flows bring further grist to the mill of the black economy.

On account of the risk involved in operating in the black economy, a number of avenues are used to put back a part of the resources used in the black sector into the legal economic framework. In any case, there are some input-output linkages between black and legal economies, i.e. black sector inputs enter legal economic activities and vic -versa. Thus, resources move out of the legal into the black economy and vice-cersa. With such a long period (dating back at least to the years of the World war) of its existence, black economy is a well-entrenched component of the Indian economy. During any given period there are a large number of varied activities centring around the black economy which are carried out with many cross flows

between the black and the legal economies, or, sectors of the economy.

Except for the building up of one's personal wealth through black-incomes or direct conspicuous consumption, the rest of the uses of black-income generate further flows of black-money which are entirely a part of the black-economy circuit. Whether the supplier of the items of conspicuous consumption declares his income and in what proportions for tax purposes is a separate matter. Thus the manifestations of black-income in any economy at any point of time are not only in the form of unaccounted cash balanced i.e., black-money but in the form of unaccounted personal wealth, real estate and most important of all, stocks-in-trade, financial claims, and productive capacities financed out of black-income which generate incomes which are totally a part of the black-economy circuit. These economic activities, based on undeclared incomes, may be taken to constitute the black economy, the parallel* economy or the black sector of the economy.

*The popular term 'parallel' economy is something of a misnomer in so far as the 'black' and the 'legal' economies have a number of connecting inter flows. About its the pervasiveness the Finance Minister said in Parliament (July, 1971), "a parallel black economy is functioning in the country every minute black money is being created" (Quoted in Mohandas, M. Op.cit. p.11).

It would appear from the above that what has popularly come to be knows as black-money is a part of the problem of unaccounted economic activities and resulting unaccounted incomes (with both monetary and real counterparts) belonging to the illegal black sector. What is the relation between the volume of such unaccounted incomes and the part of it which at any given moment of time is found in the form of money is difficult, in the nature of the case, to determine empirically. It is true that quite a significant part of such economic activities based on illegal money would generate huge amounts of cash flows which will not form a part of legal monetary transactions. A given initial amount of black-money will, over time, generate a many times larger volume of black-money. It will not be far too unrealistic to presume that luxury consumption and illegal graft use of money too is likely to circulate in the black circuit itself.

However, the fungibility of money or credit is well-knows, making any rigid division between black and non-black-money inoperative. As a result, an exclusive concentration on the problem of the black or parallel economy as a problem of black-money could not only be an over-simplification, but by mistakenly identifying

money flows with income flows and stocks of wealth, a number of schemes of unearthing black-money may prove to be either ineffective or inadequately effective.

It would appear from the preceding that the real problem is that of the black economy. Since a given quantity of black money circulates many a time during an year, the volume of black economy transactions and the real, physical flows of goods and services represented by them, are a multiple of the volume of black money in circulation. However, given the underground nature of such transactions, it would be very difficult to arrive at a reasonably accurate estimate of the proportion between the black and the legal sectors of the economy, just the same way as it is not feasible to estimate the volume of black money, in circulation over any period of time.

Are the estimation of the size of the black economy and their detection two vastly different tasks? The former is supposed to be a forte of economists while the latter task is supposed to be the responsibility of the tax-administration. It may be suggested that the estimates may help diagnose an appropriate policy response to the phenomenon of the black economy. However, the close

affinity between the tasks of estimation and detection of black economy tend to dim the prospects of arriving at meaningful estimates of the size of the black economy.[6]

It can be seen that any estimation of the size of the black economy has to be preceded by an analysis of various mechanisms and devices through which it is produced and reproduced. This is an exercise which it is difficult to accomplish with the help of conventional tools of economic analysis, because despite the operation of normally assumed economic motivation, the channels soubht by any operator in the black economy are non-conventional, closely-guarded secrets and extend to the entire range of 'human' ingenuity. Thus, one may at best, prepare a plausible model of all the inter connected channels of black transactions, which is internally consistent and is based on some evidence about detected methods of tax-evasion and uses to which such evaded resources are put.

Some indirect evidence about such mechanisms may also become available by cross-checking the internal consistency of some published and available data. For

example, data concerning power consumption and road transport tonnage may be checked against returns on levels of production submitted by various factories and plants. Moreover, overall data concerning turn over of luxury class hotels and other luxury goods,

growing difference between property tax proceeds and compounded value of real estate based on current levels of house-rents, particularly in urban commercial areas, divergence between sales-tax and excise duty assessment levels for goods covered by both, etc. may indicate some possible black economy channels. Banking data may also show some mechanisms. Estimates about the extent to which controlled prices of various goods diverge from the black prices and data concerning the turnover of such goods, total sale deals of real estate, transfer of import licenses or resale of imported goods over different periods of time may enable one to guessestimate the size of some components of the black economy. However, this information relates more directly to various devices for earning black incomes. However, basically, it is some prior hypotheses about various possible devices and channels through which simple, compound and political balck incomes are generated and regenerated, which will make one look at data discrepancies with this particular end in view. Hence,

not much purpose is served by attempts to estimate the size of the black economy; besides, it is a rather uncertain exercise. Much more useful would be attemps to spell out various mechanisms of the production and reproduction of black money in the black economy and the interpenetration between the black and the legal sectors.

From the foregoing it is clear that the phenomenon and problem of black incomes operates not only in the circulation sphere but also in the production (real) and control spheres. Basically, it is a phenomenon originating as a result of the interaction of the real and control spheres. Having come into existence, the processes of its extended reproduction and disposition make it flow through the circulation sphere. Hence the policy responses aimed at curbing it will have to be based on its three forms (simple, compounded and political) alongwith a clear recognition of its origins through a process of interaction of the real and control spheres. An explicit recognition of the role of the circulation sphere largely as a means in the course of self-expansion of black incomes helps to do away with the popular notion of viewing the problem mainly in the form of a black money problem i.e., predominantly a circulation sphere problem.

Such an analytical framework sets the stage for determining the possibilities, limits and instrument-mix for dealing with the black sector of the economy. In so fr as the malaise of the black economy arises from a specific kind of interaction mechanism of the real and control spheres, interventions in the economic or real sphere alone would hardly suffice to stamp out or sizeably reduce the black economy transactions. It is a real political economy question in a very strong sense of the term.

NOTES

1. We have not discussed tax-avoidance separately from tax-evasion, though the two are separate and distinct processes. Shenfield, A.A., "The Political Economy of Tax Avoidance" (The Chartered Accountant October, November and December, issues, 1969, pp.243-47, 281-3 and 376-84) discussed various types of tax avoidance. He suggests that, "Avoidence is normally akin to evasion because their aims are essentially similar, i.e., to circumvent the intention of the law. If successful they both bring the law into contempt ... Avoidance leads to evasion." (p.376) He points out various reasons why avoidance is unfair and wasteful.

2. Many economists have discussed the factors which determine the extent of tax evasion such as the probability of detection, penalty rates and the allocation of resources to minimise tax returns. See, Singh, Balbir, "Making Honesty the Best Policy." Journal of Public Economics, Vol.2, No.3, July, 1973 pp.257-63. Also Srinivasan T. "Tax-Evasion A Model." Journal of Public Economics. November, 1973.

Gandhi, Ved, P. (Tax Avoidance by Companies : An Empirical Test of a Hypothesis, The Chartered Accountant Sept. 1968, pp.137-9) pointed out that "as the income tax rate rises, the tax payers so try to adjust their economic affairs as to reduce their taxable incomes and hence their tax liability. They attempt : (1) to substitute non-taxable incomes for the taxable sum, (2) to claim as large a sum as possible by way of tax-free deductions and allowances, and (3) even to conceal certain parts of their incomes from the income-tax authorities." (p.137) A leading income-tax practitioner has opined that the higher is the tax rate, the large is the incentive to reduce the tax base.

3. See, Nayak, Satyendra, S. "Illegal Transactions in External Trade and Payments in India" Economic And Political Weekly 10 December, 1977. pp.99-103. He has done the exercise by making use of partner data and customs data. His analysis shows that India there has been a greater tendency to underinvoice imports and exports than to overinvoice them. This has increased the demand for illegal foreign exchange for financing smuggling and import and export invoice manipulations. His conclusions have been criticised by Pitre, Vidya, "Illegal Transactions in Trade and Payments" Economic and Political Weekly, July 15, 1978. pp 1154-56.

(4) Non-recognition of such a distinction leads to clubbing together of all "unaccounted incomes", which makes an understanding of the processes of generation and multiplication of black incomes difficult. It also obstructs the process of policy formulation capable of dealing with the multifaceted character of the blackeconomy. For instance, it is maintained that "black money is unaccounted money. It comes into existence by tax evasion, concealing incomes, smuggling, counterfeiting and racketeering, etc. All these result in the creation and circulation of black money in the economy. We can say that income or money which is created from illegal deals or sources is black money" (M.Mohandas, "Black Money - the malady and the Remedy" in Southern Economist, September 15, 1972 pp.11-15)p.11.

It is obvious that this "formulation" does not distinguish between simple, compound, political - administrative black and criminally obtained incomes. It also does not distinguish between black money and income. The unanalytical approach limits the possibilities of a systematic approach to the problem.

5. As Mohandas, M.maintains, "Moreover, in manycases, it is difficult to distinguish between black money and whilte money" (op.cit p.11). As Malcolm S. Adiseshiah, puts it, "In fact there is no distinguishable, identifiable black sector in the economy. In almost all major transactions black and white money are so mixed in that they cannot be separated, and only a part of the unaccounted transactions is in money form" (A Mid-Year Review of the Economy - 1981 p.13. The Associated Chambers of Commerce and Industry of India, New Delhi, 1981)

6. For various estimates see, Kaldor (1956), Direct Taxes Enquiry Committee (1978). R.K. Sehgal, "Extent of Tax Evasion and Avoidance: An Estimate." Economic and Political Weekly. Vol.II, No.II, No.29, July 22, 1967 & (pp.1301-1302) showed that of the expected rise in tax yields in 1960-61 over 1950-51, only 43 percent was collected and as much as 57 percent was successfully evaded or avoided. Since the estimate is based on the assumption of unchanged distribution of income, it will be something of an underestimate.

Rather than misallocate resources for "estimating" the size of the black economy, itmay be for more useful to monitor some important indicators of the size of the black economy. As Malcolm S.Adiseshialb (op.cit),pp. 13-14) has suggested, "There are certain indicators of the recognition of the black money in operation. They include situations/where the velocity ofmoney incomes is higher than the established velocity, whenever the rate of returns is demonstrably and several times higher than the normal business returns, wherever the taxable value of a transaction is below its actual value, and wherever the prices of gold, silver and real estate rise fater than the rate of increase in general prices". Referenc to Commerce; Volume 142, No.3633, Bombay, January 1981)".

THE BLACK ECONOMY: ITS CONSEQUENCES

Economics as a formal discipline has generated a model of a private enterprise market economy which is free of the role of force and fraud. Given the fact that replacement of non-economic force by free contract was the diffentia specifica of capitalism as an emergent economic system, it is difficult to visualise how it could incorporate force as an essential instrument operating largely as a systemic characteristic. However, despite the general validity of abstracting from force as an operational variable, it is equally unrealistic to deny that in the course of capitalist development institutionalised use of force or violence in order to ensure certain economic relationships did not come to play a growing role.

Many laws, with strong penalties, were enforced to curb the right of labour as well as weaker industrial rivals Colonisation was also based on the use of force for unilateral economic interest of the metropolitan centres. As Fawzy Mansour puts it, "To that mode of surplus extraction (Slavery) corresponds the first stage

of the development of the world capitalist system: that of <u>primitive accumulation</u>. Direct plunder, the imposition of tributes and fines, the use of slave labour in plantations and mines, the eviction from their lands of native population in the old as well as the New World - these as well as other forms of the use of arbitrary violence for surplus extraction belong to that period." ("Third World Revolt and Self-Reliant, Auto-Centred Strategy of Development" in <u>Towards a New Strategy of Development</u>, Rothko Chapel Colloquicem, Pergamon Press, New York, 1979, p.212). He charactertises the colonial stage in the development of world capitalism as based on institutionalisation of violence into political power.

Similarly, the abstract assumption of perfect knowledge and free, universal and equal access to information was basic to competitive capitalism of small entrepreneurs. In such a goldfish-bowl capitalism, apparently, fraud could have no place. However, as information and knowledge became private property and an increasingly important source of economic power, the distinction between secret, well-guarded knowledge and fraud started wearing thin.

This is no place to go into the role of force and fraud in the working of capitalist economies. What is sought to be suggested is that the phenomenon of black economy is a living evidence of the conjoint operation of force and fraud in economic life, especially because of the existence of what we have called political black "incomes" and compound black incomes which are an amalgam of both fraud and force. In other words, the phenomenon of black incomes is an evidence of lumpenisation of capitalism as it moves from monopoly capitalism to state monopoly capitalism. In any case, colonialism, an important form in which capitalism reproduced itself on a global scale, was from the very beginning, rooted both in force and fraud.

It is difficult to follow through the implications of the sustained operation of the black economy because, force and fraud being its kingpins, it is difficult to prepare and verify a reasonably accurate model of the economy with an important underworld black sector with innumerable links with over-the-surface sectors. The difficultires are not restricted to the preparation of a model of any economy with black sector. Since the formal, legal economy is only one component of the system,

and, in effect, operates in close contact with the black sector, the formal model of the legal economy is incomplete and fails to represent the reality. Many transactions become complete and explicable only when the closely intertwined black and legal (white) transactions are taken together as a unit. Hence it is difficult to generate a picture of the economy without the black sector which is verifiable.

Since we have neither a realistic and verifiable picture of the economy with the black sector nor a picture without it, it is difficult to present a comprehensive analysis of the consequences of the black sector. Thus what we attempt in the following sections is an attempt to show, one by one, in isolation, some of the selective consequences of the operation of the black economy.

It may also be pointed out that the consequences resulting from the operations of the black economy are very closely related to various channels and devices through which

i) the black incomes are generated,

ii) the black incomes are utilized and

iii) at various points in the course of its extended life cycle, a part of the black incomes is converted into legal incomes.

Thus, our discussion of the consequences of the black economy would have a bearing on the analysis of various mechanisms for the genesis and extended re-production of black incomes.

One of the most significant consequences of the large and growing black economy is the fact that it qualifies in a very serious manner one's claim to know enough and correctly about the Indian economy. There is no dearth of studies and statistics about the course of development the Indian economy has traversed over the last three decades or so. However, in every sphere, there are sizeable black incomes and a large number of transactions are consummated every day leading to a proliferation of the black incomes and related monetary and real flows. Hence the capacity of the system to throw sufficient evidence about the actual mechanism of its operations and the magnitude of the key variables and their inter-relationships is significantly compromised. An important manifestation of this qualification of our knowledge about the Indian economy is reflected in the difficultires experienced in estimating the volume of black incomes and related cash and real flows and stocks of various kinds of wealth. But even

to draw a comprehensive picture of the channels and devices used in the black sector of the economy becomes a difficult task. However, even a preliminary and somewhat tentative analysis of this kind is an essential task for many cognitive and policy reasons.

Hence it does not really matter that a brief analysis of some of the consequences of the operation of the black economy which we are attempting is itself subject to the lack of trust-worthy knowledge about the actual modus operandi of the Indian economy and involves elements of judgement. However, a brief analysis of this kind is essential not only in order to under-line the gravity of the problem, but also to understand the areas in which interventions are essential.

It can be said that the operations of the black economy cause serious repercussions in the real and circulation, (exchange) spheres and lead to distortion of their mutual relationships. The first serious and easily visible effect produced by the black economy is related to the basic source of what we have called simple black incomes, i.e. non-payment of taxes according to law. This leads to a sizeable loss of revenues to the State exchequer which creates an entire range of

repercussions on the fiscal and other policies of the State bringing in their turn a series of effects on the real and circulation spheres of the economy.

Since our tax system is suppose to lead to reduction in disparities of post-taxation incomes, evasion leads to blunting of the effects in this direction. In fact, it can be reasonably postulated that the bulk of the tax evasion takes place in property incomes as different from work incomes, which are either too low to come under the tax net or if are sizeable enough to be taxable, have few escape routes. Thus one would concur with Dr. D.K. Rangnekar when he maintains that as a result of tax evasion, "while the tax paying public finds its own incomes falling, the non-tax paying public is having a free run of swelling concealed incomes thereby adding a new dimensions to the problem of inequality of incomes and wealth." (DTEC, Note of Dissent.p.249).

There are some other ways in which operations of the black sector contribute to strengthening of the economic and power basis of the relatively better off sections of society as against the under-privileged ones. It is well known that black incomes contributes to lavish consumption, purchase of precious metals and stones and other high

priced superfluities. Such conspicuous consumption is a net deduction from potential investible resources and is effected at the cost of loss of production of mass consumption goods and employment avenues. Thus the wherewithal for fuller employment are curtailed while production which attracts further utilization of black incomes is encouraged. The phenomenon of large scale smuggling and distortion of the product-mix in favour of non-essential items is encouraged.

The implications of these activities on the loss of precious foreign exchange are many. It has been argued that "since foreign exchange violations are possible only through clandestine dealings, these necessarily result in evasion of income tax and other allied taxes." (Ibid, p.61)[1] Since about ten years ago, such foreign exchange leakages were estimated to be of the order of Rs.240 crores annually (Ibid, p.61), one may well imagine their present staggering dimensions. One does not have to think too hard to visualise the consequences of the availability of foreign exchange of this magnitude in terms of either lower external borrowing and stronger external relations or in terms of the spread effects of investments of this magnitude. Since such evaded sums are used, afterall, by some unscrupulous segments of the society, it wonsens the lot of the rest of the society. The consequences of the expansion of such

production and the loss of essential production in terms of the phenomenon of the inflation are also fairly obvious. Thus by fueling the fires of inflation, the black economy transactions have also contributed to sizeable off-setting of the increments in nominal incomes which have taken place during this period.

Since the real and circulation spheres of the economy have very significant linkages with the control spheres of the economy, we can trace the effects of the forays made into the system by black incomes by following through the consequences of these transactions in the control sphere.

The most eloquent feature of the economic interventions made in the Indian economy through an extensive set of economic policies, loosely integrated in the framework of a National Economic Plan, can be said to consist of the wide gap separating the policy intentions from policy outcomes. This shows a very high degree of ineffectiveness of policy design and implementation. An experience over a certain length of time of going ahead with this kind of ineffective policies leads to further distortions of the policy choices. What Myrdal has described as the "Soft State" is basically a State

which in the first round fails to achieve its policy objectives and based on the demoralization caused by such failures successively adopts policies, which are relatively easier and inadequate options, and are bound to boomerang.

Thus, for instance, one finds that failures to raise anticipated taxation leads to hiking of the tax rates and widening of the tax base. However, this exercise turns out to be self-defeating because with successful experience of tax evasion at lower rates, the activities of evasion are undertaken with greater vigour and on a still more expanded scale at the higher tax rates. The new economic and political power which emerges out of such black incomes renders the expansion of the tax base difficult leading to greater resort to deficit financing, external and internal borrowing and that euphasism for conversion of black income into 'white' called small savings. Similar fate awaits monetory policy and direct and indirect controls, etc.

Though we view the phenomenon of tax-evasion and its consequent petrification as a black sector problem, there is no gainsaying the fact that black money remain one of its major manifestations. These hordes of black money are a highly mobile lot, ever out to make an attractive

return. As the Direct Taxes Enquiry Committee (DTEC) put it, "In this parallel economy, there is apparently no lack of anything, no lack of facilities, and certainly no lack of 'money', provided the price is suitably 'black'" (p.5). With such large sums waiting in the wings, ready to move out on their prowl, no policy of control over the supply of money and credit can succeed except when it is expansionist in keeping with the inherent drive of black money. With the relatively high rates of interest obtaining in the black sector, any preferential credits given for high priority uses tends to deflect these intended resources into non-priority, 'black' uses. So long as the expected rate of return from any trading or other economic activity is acceptable as adequate, no dear money policy can curb such uses until the latter is so high as to exceed the expected black sector returns. Similar fate awaits selective credit controls.

Price controls, movement restrictions, industrial licensing, foreign exchange regulation, import restrictions, and all the other controls and restrictions are made less effective and distorted through black incomes. The larger the volume of black incomes, the greater is the utilization of these sums for frustrating the purposes and design of controls and regulation. The actual operation of the

system approximates the uninhibited market model on the basis of the use of black incomes to frustrate governmental controls and regulation.

Indian planning is an attempt to give a thrust and direction to the market-led processes of expansion mainly on the basis of increasingly growing volume of public investment and the consequent withdrawal of resources in a relative sense from the private channels. The growing size of the black sector limits the possibilities of increasing public investment. Even the scheme of financing such investments is seriously influenced by the size and operation of the black sector. Since all the economic policies are supposed to be integrated under the overall logic of the plan, the weakening of the drive to raise public investment and lower effectiveness of each of the individual policies through the impact of the black economy combine together to render the scheme of social determination of the rate, pattern and path of development ineffective. Most of the formal analytical attempts at explaining the divorce between the stated objectives of the plans and the observed course of development turn out to be inadequate, if not misleading, owing to their inability to gauge the implications of the black economy.

In the real, production sphere the effects of black incomes are not confined to qualitative aspects alone in the sense of distortion of production structure in favour of luxury consumption goods. The luxury consumption goods (except for those produced in the handicrafts and artisan sectors) have, generally, relatively higher capital, imports and skill intensities. It means that relatively larger quantities of inputs are locked up in their production, except for semi and unskilled labour whose employment opportunities are, in fact, limited on account of relatively lower labour-intensity of most of the items of conspicuous consumtpion. Since black incomes are prone to have relatively higher attraction for those items of consumption which may go unrecorded, they have a tendency to be used for the production, sale and use of a number of services. The services sector, supported by black incomes, expands to an abnormal level because here production and consumption are instantaneous which makes detection relatively difficult. Moreover, a number of services like those of agents, touts, brokers, musclemen, lumpen political operators etc. are required in order to operate the black economy. Liason men, income tax advisers and 'social workers' are for the most part only glossy cover names for a number of new occupations facilitating the ever expanding operations of the black sector. The

experience of India with the increasing share of the tertiary sector in the economy (in terms of contribution to GNP and in employment) is related, interalia, to the operations of the black economy.

It amounts to tilt the balance against material production in comparison to non-material production. At a relatively lower stage of economic development, India tends to display some of the features of relatively more developed economies, like the position of the tertiary sector, owing to distortions caused by the black economy.

The bias against mass consumption goods and for luxury goods and inessential services fostered by black income, is specifically reflected in the building and construction sector in a particularly sharp manner. Black incomes can easily be held in the form of real estate, where it is not difficult to understate the values. Moreover, this understatement does not adversely affect either current returns or future appreciation. The considerations that current returns may also be concealed and that appreication of values is untaxed so long as the property is not disposed of add to the attraction of real estate as a receptacle of black incomes.

Moreover, one may acquire real estate at many different places, under fictitious names, or under the names of trusts, etc. If the buildings are used for personal use, the attraction is not reduced because in this way, one "consumes" the services ofa building of a much higher value than is declared for tax purposes. When one is to gift such buildings, or when such buildings are to be bequeathed, or for wealth tax purposes, the lower stated values help the evaders all along. Grand mansions are highly conspicuous and add to social prestige and status. For a variety of such reasons, the lure exercised by real estate for black incomes remains undiminished.

These tendencies have led to unprecedented increases in the actually obtaining prices of land, buildings and construction materials. This has made housing for the non-black earners a nightmarish problem, increasing the gap between housing needs and supply. Resources have flown into high-cost, high-rise luxury buildings and apartments while housing for the salaried white and blue-collar workers and the peripheral unorganised sector workers has languished. The consequences of such house-builing, neglect of popular construction activities and frequent sale, purchase and speculation in real estate not only

boost the black economy, misdirect resources, raise rents, lead to loss of tax revenue, add to slums, congestion and traffic problems, but also adversely affect locational decisions about various economic activities and foster inefficiencies and waste in the industrial sector.

Another distoration in the real sphere is purchase of land and other assets for non-taxed or lightly taxed activities like agricultural lands, orchards etc., and their non-utilization and/or inefficient utilization. The main purpose of "investing" in these assets (and not so much, activities) is to show through cooked up accounts "profits" in these activities. Thus regular conduits are prepared for legalising black incomes.

As a result of black operations, costs of production are overstated and, to a certain extent, are actually jacked up. This adds to the inflationary tendencies of the black economy. Since physical production, prices and turnover tend to be understated on account of their unauthorised character, neither actual production nor inter-sectoral linkages, become truly known. However, since black market operations tend to aggravate shortages, they tend to push up reported prices as well. Similarly, the extra,

unauthorised production in certain preferred lines of production is obtained by reluctance to go in for and consequent loss of production of certain different kind of goods. Hence it would be without much basis to expect that black operations lead to really higher rates of growth of production than reported. The major impact is in terms of changing the product-mix, relative prices and absolute price level.

In so far as black incomes are used for buying precious stones, bullion, jewellery, etc., it is an unproductive use of resources with all its well-known consequences for the rate and pattern of growth. The demonstration effects produced by such spending further strengthen similar trends of distorting and slowing down of the growth process.

The high premium generated by the black deals for scarce and/or imported raw materials and components go against fast, balanced and equitable growth. In this way, not only smuggling and wastage of foreign exchange are encouraged but a general tendency to go in for more imports becomes stronger. High premium on foreing exchange

resulting from these forces, including the need to finance smuggling, leads to sizeable leakages of foreign exchange earnings through under-invoicing of exports and over-invoicing of imports.[1] Among these leakages are also included "secret cuts and commissions on joint ventures and collaboration aggreements involving Indian and foreign parties." (DTEC, Final Report. P.5). These processes accentuate foreign exchange scarcity and reinforce the premium placed on it. Its impact in terms of loss of investment opportunities, greater recourse to external borrowing and liberal concessions to attract foreign private capital is related to both slowing down of the tempo of import-substituting industrialization and higher priority to competitive export-promotion. In general, it contributes to weakening the drive towards self reliant development.

The DTEC has brought out another aspect of the impact on foreign economic relations. The processes discussed above lead to building up of illegal and clandestine foreign exchange reserves held abroad in various forms. As a result, there arises "the oddity that a country, where capital and more particularly foreign exchange resources are scarce, become a defacto lender of aid and capital to economically

advanced wealthier nations, with the concealed outflow of funds." (DTEC, Final Report, P.6).

In the field of circulation and finance, the phenomenon of the black sector creates many sided effects. While a certain portion of black incomes is kept immobilized in the form of cash-balances, and a certain part is locked up in real estate, bullion and other forms of hoarded wealth, there is a certain portion which is used in trade, speculation, stock-piling and for financing productive activities. While the legally permissible asset-forms available for black savings are definitionally limited, in reality there are ample clandestine forms of assets or illegal methods of holding assets available to black savings. To presume that financing of industrial productive assets by black savings generally is possible only in the unorganised sector is also a partially true and naive view. (Sundaram & Pandit, op.cit.p.145). Except for the public sector, it is possible to obtain under-invoiced capital equipment as the producess, large or small, also reduce their declared incomes by under-invoicing and accepting the difference in under the table cash. Similar manipulations through over-invoicing are possible in the case of imported equipments and plants leading to leakages of foreign exchange.

While the hoarded cash reduces the effective supply of money, a good part of the prices of real estate and other personal wealth which comes from the black circuit also gets immobilised. However, the part of black incomes which is used as commodity capital, finance capital or industrial capital usually circulates with a relatively greater degree of rapidity. This is for two reasons. The greater the rapidity, i.e., the shorter the turnover period, the higher the return. The risks associated with these transactions tend to push up the expected rate of return. Then, the quicker the turnover, the lower is the risk of detection. Thus, in general, the extent to which monetary resources are immobilized through the retention of black incomes in the form of black money and its conversion into unproductive assets the effective money in circulation is reduced. However, this may be more than offset by very high rate of turnover sought by income-yielding uses of black incomes. Thus, we disagree with the view that black incomes saved in the form of cash is anti-inflationary and "corresponding to the part of black savings held as currency, Government can without inflationary consequences finance additional real investments by supplying additional currency". (Sundaram and Pandit, op.at, p.146) Black money cannot provide cushion against deficit finance owing to the former's higher velocity of circulation and stock-piling of goods financed by it. It is wrong to presume that much of the black money stays put idle.

The continued operation of a sizeable black sector tends to push up the expected rate of returns on investments of all kinds. This is so because the risks associated with black transactions are high and socially and economically far more serious and injurious. Then, black transactions own their origin to a search for higher net returns than may be permissible from normal, legal activities. Since the entire surplus resources obtained in the black sector cannot be ploughed back and a safety margin of liquid and easily encashable resources has to be maintained, the rate of return on the invested sums has to be relatively higher in order to give a reasonable average on the entire surplus (saved) black resources.

The tendency of the black rates of return to be of a high order influences the expected rates of return and disposition of resources in the legal sector as well. Though market imperfections impede the operation of the law of average rate of profits, yet the magnetic pull exercised by high rates of return obtainable in the black sector tend to deflect resources, over a reasonably long period of time, to uses which promise to ensure relatively high rates of return. The tendency for misallocation of resources in favour of luxuries and non-essentials with

high capital, imports and materials intensities and away from mass consumption goods also derives in some ways from the influences extorted via the law of average rate of returns which is distorted by the high rates obtainable in the black sector. The speculative holding of commodity stocks is also encouraged. In general, these tendencies contribute to shortages of essential goods and strengthening of inflationary pressures. This is a process which affects both the real and the circulation spheres and brings about some changes in the basic mode of operation of the economic system. Wihtout a reasonably clear perception of these processes, the control sphere would not be able to base its areas, modes and extent of interventions on a realistic set of assumptions.

What is the relationship between the growth of black incomes and savings behaviour in the Indian economy? The question may be split up into two parts: magnitude of savings and the sources, forms and mode of utilization of savings.

Before one comes to these questions, it may be stated that in so far as tax-evasion adversely affects budgetary surplus, and hence savings on government account and, in so far as there is sizeable conspicuous consumption

out of black incomes, the overall impact of the black economy on the rate of savings in the economy is likely to be adverse, However, the concentration of income and wealth facilitated by the black economy operations tends to push up the propensity to save.

Though savings out of black incomes may well take the form of financial assets of various kinds or the form of physical assets including stocks-in-trade, there will generally be a preference for the former. This is because of the ease with which the financial assets may held, sold and moved from one place to another. Thus one sees that household savings in financial assets have increased from over 38 percent in 1970-71 to about 52 percent in 1978-79 (National Accounts Statistics, 1970-71 - 1976-79, CSO, New Delhi, Jan. 1981, p.39). To an extent the rising share of household savings vis-a-vis private corporate and public sector savings may also be attributed to rising magnitude of black incomes.

It may well be appropriate to sum up the entire range of effects produced by the continued, increasing and varied operations of the black economy in terms of the rate, pattern and path of development experienced in the

country over the last three decades. The issues covered by our discussion so far have not taken into account more directly social and political factors as well as the interaction between socio-political and economic factors.

Without going into the complex mechanics of socio-political processes operating under the impact of the black economy, some general propositions may be made on these questions. In so far as dominant economic interests intervene in the political processes, sizeable black incomes provide both an effective means and strong motivation for bending the political processes to serve the general interests of the rich and the propertied. However, the crunch of these operations come specifically to help those of these groups prosper who could establish a modus vivendi with the political strata at various levels. This redirection of politicies or distoration of stated policies in order to defeat their stated purposes or their lax and perverted implementation, has operated over a very wide area. Many laws and policies like land ceilings, resumption of lands for personal cultivation, cooperative societies, assessment and collection of taxes, industrial licensing, enforcement of labour laws, granting of import licenses and quotas, allocation of scarce raw materials,

etc., have been implemented in such a distorted and perverse manner as to make them counter-productive.

It is true that the overall balance of forces and distribution of control over levers of power in the society is enough to ensure that the policies and programmes designed to restructure social set up and benefit the relatively wrose-off sections are defeated in a number of ways. Thus the black economy does not in the main provide the foundations for the actual socio-economic content of public policies. Its role is basically that of a mediating mechanism with the help of which the dominant interests further entrench themselves. Thus, it is not suggested that but for the black economy the declared policies and programmes springing from the overt and formal political processes would have been truthfully implemented. But it may well be suggested that the growing volume and operations of black incomes gave to the dominant economic groups an assurance that even if radical policies and programmes are accepted at the level of declared policies and programmes, there will be many more opportunities to see that their interests, instead of being eroded, are infact, protected and promoted. With the power of black incomes at their behest, the pace of implementation can be slowed down;

legislation may be drafted as to blunt the edge of their purported intent and, many deliberately implanted loopholes and exemptions may qualitatively change the thrust of the proposed measures.[2] On top of it all, when it comes to individual cases, black incomes will enable them to escape the consequences detrimental to their specific interests.

Thus the black economy becomes a means to reconcile some apparent oddities and contradictions inherent in a highly differentiated and oligopolistic economic structure with the parliamentary adult-frenchise based political democracy. The latter ensures a periodic legitimation of the rule of the dominant classes, not only through elections and political processes but also by acceptance of some kind of socialistic rhetoric based policies and programmes. The black economy is among the important means used to ensure that none of the aforementioned policies and programmes really go very far either in their general conception or their specific applications. The phenomenon of widespread political corruption and politics of money power are deeply ingrained in the system with a very specific role. As a result, the social values and ethos have degenerated.

Therefore, the Indian 'development' experience significantly relates to the phenomenon of black economy, both contributing to it and deriving from it. Its very conception is basically that of a State-catalysed expansion of the domestic market reflected in the rate of growth of national income. Its frills and correctives in terms of fuller employment, greater equality in social and economic spheres and greater self-reliance, come into conflict, beyond a point, with the uninhibited pursuit of expansion of GNP. However, it may be risky politically to make a sharp and openly acknowledged adjustment in favour of GNP growth beyond what is permissible by the false consciousness bred by pseudo-scientific growth and modernization theories. It is here that the black economy steps in for completing the job of maintaining a power structure, administrative machinery and dominant ideological framework which permits the game to be played as the surface and subterranean powers would like. It is not only anti-development growth but is a sharp and pointed lumpenization of the system as well.

NOTES

1. These methods of financing smuggling indicate the clandestine nature of such foreign exchange leakages. These methods include: (1) sale process of goods smuggled out of India, (2) deflection of inward remittances to unauthorised obtaining of foreign exchange e.g. through tourists, etc., and (4) manipulation through overinvoiced imports and underinvoiced exports". For details, see, Mohandas, M. Op.cit, pp.12-13.

2. Shenfield, A.A. 'The Political Economy of Tax Avoidance' Op.cit. p.281 makes an intersting distinction between "Tax-trap" and "Tax Loophole". Tax-trap is the case, according to him, where a tax law is so drafted as to catch more than it was intended to catch. The apposite is the case with 'Tax loophole' which arises where the law is so drafted as to catch less than was intended. Obviously, it follows that tax loopholes are indicative of the approach of the government towards taxpayers.

III

Public Policy Response to Black Economy: A Review

Even granting the symbiotic relationship between the black sector and the political system, which arises from the phenomenon of increasingly lumpenised, post-colonial, collaborationist State monopoly capitalism, there are reasons for the State to do various things which are intended to interfere with the unbridled growth and expansion of the black sector.

For one thing, the size and operations of black incomes may become more dominant and pronounced in certain specific economic activities and areas. This may disturb the internal balance and harmony within the dominant classes. For example, increased black operations in wholesale trade in essential commodities may fuel the fires of a two-digit inflation to the detriment of a reasonably stable cost structure, economic calculations and social tranquility. These operations may so strengthen the industrialists in certain sectors and/or industries that the industries using their output (forward linkages)

may find a squeeze on their surpluses, particularly if they may be facing a buyers' market, (and are unable to shift the burden on to the consumers).

Then, it is widely acknowledged that for a complex set of political and economic factors, the system finds it uncomfortable to cope with growing absolute poverty and pauperisation which is an inevitable result of the most regressive from of concentration of income and wealth represented by the growing penetration of the economy by black incomes and wealth. Similarly, the growth of black incomes in connection with external economic relations (through kickbacks, illegal external deposits, increased opening up to MNCs, crippling external debt burdens, etc.) may limit national options. In addition, the fiscal dilemma of the State intensifies as more and more sources of revenue show inelastic returns owing to leakage into the black sector. For a variety of such reasons, the State finds it necessary and expedient to assert its overriding powers vis-a-vis the black sector. A large number of more directly political factors (like greater collaboration between some black operators and certain specific political groups and parties), a certain sense of moral shock at the increasing ruthlessness and ferocity of the black operations and emergence of specific political mobilization

against either some specific forms of black operations or against some individuals or groups whose 'indiscretion' becomes too glaringly exposed, etc., are factors which make the State take some steps designed to deal with the **black** economy.

What are the possible objectives of such state actions concerning the black sector and its expanding orbit? At the most fundamental level the objective could be to do one or all of the following:(control variables and objects of control):

1. unearth the black incomes obtained in the past and converted into various assets;

2. eliminate the present activities leading to generation and expansion of black incomes;

3. bring about changes in the structure of the economy, in economic policies, plans and balance of power in the economy in order to prevent the generation of black incomes in future;(instrument variables).

4. to curb the size, avenues and scale of operations of the black sector, so that gradually the total size of the black sector is brought down and

increasingly fewer avenues are available to it for further proliferation;

5. to induce black incomes and stocks of wealth based on black incomes through a system of carrot and stick to come to the surface so that the mischief produced by the black sector is somewhat reduced and it becomes available to the State for financing its general budgetary and planned activities. Under such a perspective, black incomes and wealth are, through a fiat, bleached 'white' and some incentives are offered for transferring their use to the State for a stipulated period of time.

The objective in these attempts is to legitimise such resources as well as to utilise them for public purposes. Under this framework, not only the stigma and risks associated with the black sector are withdrawn, but some returns are also offered for parting with some of the monetized black wealth for a period of time to public authorities.

In India the efforts made so far to deal with the black economy fall under some distinct categories.

First, a large number of legal and administrative measures have been taken to deal with tax evasion, i.e. simple black incomes, since the inter-war years. In 1936, the Ayers Committee made a review of the income tax system in India. On the basis of its recommendations many changes were made in the tax laws, which, inter alia, sought to strengthen the machinery to deal with frandulent evasion as well as legal avoidance. Since the War time shortages, controls and regulations gave rise to huge quantities of black incomes, in 1947, the Income Tax Investigation Commission was set up, not only to deal with individual cases of tax evasion but also to suggest preventive measures to curb tax evasion.

The legal and administrative system has been variously changed, among other reasons, for effective tax administration curbing the generation and profiferation of simple black incomes. These changes have been based on the studies and proposals made by many experts and committees. Important among those were the Taxation Enquiry Commission, 1953-54,

proposals for the reform of the Indian Tax system by Prof. Nicholas Kaldor, 1956, The Director Taxes Administration Enquiry Committee, 1958, the studies by the Administrative Reforms Commission on Direct Tax Administration, 1969 Direct Taxes Enquiry Committee, 1971, etc. Each year the tax law has been amended and modified to plug loopholes for making tax realization effective and for imposing penalities for tax evasion. Powers for searches and seizures have been granted and penalties and criminal prosecution have been made stiffer to generate deterrence. Similarly efforts have been made to strengthen and streamline the machinery for tax administration for better compliance with tax laws.

Granting the inherent limitations of legal administrative and policing methods to succeed significantly to curb the black economy, in the Indian case the limitations become rather seriously marked owing to limited actual efforts made to curb, control or unearth the black operations. The Report of the Working Group on Central Direct Tax Administration of the Administrative Reforms Commission, (India, New Delhi, 1968, pp.110-11) costigated ineffective tax administration. It show that out of 31 cases in which prosecution was launched during the period 1960-61 to

1965-66, only in 2 cases convictions were obtained. Two cases were compounded and the accused were acquitted in eight cases. (p.110). Many reports of the Public Accounts Committee have pointed out the slackness of tax administration in dealing with tax evasion. It has been pointed out that imposing penalities in cases of deliberate, large scale tax evasion is not deterrent enough and criminal proceedings should be initiated in such cases. Even seizures and searches for tackling the problem have only touched the periphery of the problem. During 1965-1969, these efforts yielding Rs.105 crores by way of taxes and penalities. (DTEC, Final Report, p.12).

In another category of measures fall various steps taken since 1946 for unearthing that part of black wealth is kept in monetary form. Demonetisation and voluntary disclosure schemes have been the main forms which such measures took.

In 1946, currency notes of high denominations were demonitised. Another demonetisation was attempted in 1978. Being a limited and partial move, it is difficult to expect that a serious dent was made through this measure in invalidating a large part of monetised black incomes and wealth.

In 1951, a voluntary disclosure scheme, which suitably relaxed the penal provisions to facilitate the bringing into open of concealed incomes, was initiated. Not much seemed to have been done during the rest of fifties and right upto 1965 when another voluntary disclosures scheme was introduced. This scheme was introduced in two-stages. In the first stage, a scheme, known as "64-40 scheme" was introduced, according to which a tax rate of 60 percent was charged on disclosed incomes. According to the Report of the ARC Working Group on Central Direct Tax Administration (p.107), during this period, 2071 persons made voluntary disclosures on which the tax at the 60 percent rate come to Rs.38.80 crores. The average income disclosed per "volunteer" was Rs.2.60 lakhs. As against this scheme, which would generally attract those whose normal tax obligation was at 60 percent or more, a second scheme, known as 'Block Scheme' was introduced. According to it, instead of a flat rate, the tax rate payable was that which was applicable to the block of concealed incomes disclosed.

The block scheme had a much better reception in comparison to the 60-40 scheme. Some 413, 628 persons declared incomes amounting to Rs.145.51 crores, on which

tax amounted to Rs.68.27 crores. It gave an average income disclosed of Rs.12,850. Thus, though more people reasponded to it and more incomes became legal, the tax revenue realization was quite low. It compares unfavourably with the detections through administrative channels, which in any case do not show evidence of too vigorous a pursuit.

As the DTEC Report puts it, "they were more or less schemes for converting black money into white on payment of what turned out to be in most cases, a small amount of conscience money. Disclosures made in the name of minors, ladies and benamidars have, on the other hand, contributed to perpetuating evasion, and rendering investigation in many a case of suspected tax evasion difficult or even futile. The fact that in the last of these three schemes, namely the black scheme, as may as 77 thousand and odd out of the total of 1,64 226 disclosures were from persons not previously assessed to tax would bear ample testimony to this misuse of the scheme. We were informed by the Central Board of Direct Taxes that there were several instances of the same set of persons taking advantage of all the three disclosure schemes, which would belie the theory that such schemes help to rehabilitate the repentent tax evader who is desirous of mending his ways." (p.12).

It is also not clear as to what is the extent to which such "voluntary" disclosures (induced by laws condoning past offences) are availed of by those with political black "incomes". It is not too unreasonable to suspect that conversion of such incomes into income-yielding assets (except use for political purposes like financing election expenses, supporting political underlings, inducing defections, etc.) is relatively difficult. Real estate, bullion, jewellery etc. are also serious contenders for the use of such political black incomes. Thus, it is possible that open profitable uses of political black incomes entail relatively greater risks. If a scheme of "voluntary" disclosures can bleach such black incomes 'white', it facilitates their 'open' use. Thus it may be believed that such disclosure schemes hold relatively greater attraction for political black incomes. Since "the disclosed incomes are already invested surreptitiously in business or property through various devices", (DTEC, Final Report, p.12) it may be inferred that the contribution of such schemes to immobilization or socially useful utilization of compound black incomes cannot but be minimal.

In view of such factors, the DTEC was strongly opposed to schemes of voluntary disclosure, "either now or in the future." Interestingly, the committee reported that "Majority of Departmental officers and some Chambers and other representative bodies of the trading community have expressed themselves categorically against the introduction of any further disclosure schemes", which "place a premium on fraud and are unfair to the honest tax payers."(p.12). This lends a certain degree of support to our hypothesis that voluntary disclosure schemes hold some special attraction for holders of political black incomes.

Contrary to the recommendation of the Direct Taxes Enquiry Committee, 1971 and ignoring the limited effectiveness which in any case gets offset in certain important ways, (as discussed above), yet another voluntary disclosures scheme was introduced by the Voluntary Disclosure of Income and Wealth Ordinance, 1975, when the country was being ruled under the provisions of internal emergency. Under this scheme, regardless of the number of years over which incomes and wealth remained undisclosed, the amounts disclosed were to be taxed as a single block. During this period, searches and seizures had been intensified; later

on Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 was also enacted to deal with the menace. Under this Act, immovable property worth Rs.88.05 lakhs and movable property worth Rs.76.84 lakhs was forfeited. (Report of the Ministry of Finance, 1975-76). The disclosure scheme had a further provision that 5 percent of the illegal incomes disclosed and 2½ percent of wealth disclosed will have to be spent on projects of high priority like slum clearance and housing for the poor.

Under the scheme, the total amounts disclosed were placed at Rs.1578 crore, of which Rs.744 crores were disclosed incomes and Rs.834 crores were disclosed wealth. Income tax and wealth-tax payable on the above sums were estimated to be Rs.241 crores and Rs.7.7 crores respectively. Over and above these, Rs.4.9 crores out of these disclosures were invested in specified securities. (Economic Survey, 1975-76, p.25). It appears that, given the limitations and short-comings of various disclosure schemes, recurrent reliance is placed on this measure not so much to reduce the size of the black sector (which may in fact increase to a certain extent) but to raise tax revenue and redirect a part of such resources into some preferred set of uses.

The long-run implication of periodic disclosure schemes in terms of strengthening the propensity to multiply concealed incomes does not seem to receive serious attention.

A modified scheme for unearthing black incomes and wealth kept in the form of cash balances was introduced through Special Bearer Bonds (SBB) Ordinance, 1981. This time the purpose also seemed to be to bring such resource under public control for a period of ten years by exempting disclosed resources from taxation and offering a simple rate of interest of 2 percent per annum. The SBBs, 1981, will have a face value of Rs.10,000 and will be issued at par. The period of maturity will be 10 years, with the holder receiving Rs.12,000 on maturity. To inspire confidence, the scheme will be completely independent of tax administration. In so far as this condition is really adhered to it is not unlikely that after the end of 10 years, even those also **who** did not buy the black bonds take credit in their accounts for the sums which they could just clain were redeemed through maturity of the bonds. However, the actual provision of repayment through account payee cheques prevents this possibility but to that extent compromises anonymity provision. It will then produce incalculable consequences in th economy. There will be no ceilings on such investment of black resources, which may also be in the form foreign exchange.

It was hoped that by the deadline of April 30, 1981 over a period of about three months, a total sum of about Rs.1,000 crores would become available to the government by way of budgetary support.

It is obvious that this was the most "liberal" and attractive disclosures scheme so far. The purpose seems to have changed in the sense that while no tax is levied on disclosed amounts, the control over the sums passes into the hands of the government for a period of ten years. Thus it is essentially a public borrowing out of black monetary resources at a relatively low rates of interest, which are more than compensated by waiving of tax liability and penalties. In any case the rate of interest is not too low when compared with the rates offered on 10 year government bonds. In fact, in so far as the SBBs can be used as collateral, the loss of control over the resources is also partial only. There is not much point in analysing the general economic impact which is likely to follow from the scheme of SBBs. It certainly is unlikely to be antiinffitionary as the funds borrwed against the black bonds are likely to produce a turnover over a period of say one year, not much less then and may be exceading the face value of the bonds.

In brief an affective policy-package capable of effectively cleaning the economy of its black component is yet to be devised and implemented. This brings us to some important questions: why is it that despite a widespread recognition of the need for effectively putting an end to the operations of the black sector, an effective beginning is yet to take place? Why is that whatever little has been done in this connection is largely misconceived? These questions can be explored only in the context of a realization of the possibilities of and constraints on stamping out the black sector.

IV

The Problem of Controlling the Black Economy Constraints and Possibilities

The constraints on public policy intended to do away with or restrict the scope of the black economy are complex. They arise from the character of the polity, the nature of the processes of policy formulation and implementation, the nature of the economy and its operational mechanism, from the interaction between the above mentioned factors, the size, range of operations and channels of movement of the black economy and a complex network of interests evolved around these factors and forces. However, it would not be too useful to relate almost everything with the persistence of the black economy and its capacity to frustrate public policies meant to move against it, not only after their initiation but even at their pre-natal stage. Hence in the following we abstract from the relatively unimportant and subsidiary factors and underline the major constraints operating against attempts to frustrate the black economy.

The black economy, we have argued, is an important operational component of the Indian economy with many diverse links with the political system. In an economy in which the State is playing an increasingly greater role, the

phenomenon of a large and growing black sector poses many problems, not only in general but also very specifically vis-a-vis the processes initiated for restraining the black economy.

To the point of view which considers the State interventions mainly a component of the 'solution' vector, as distinct from the 'problem' vector constituted by the entire complex of socio-economic processes, the black sector comes as a buffer which is fairly immune to controls and regulations and brings about a deviation between intended and actual results of various interventions.

That is to say the black economy is not only fairly uncontrollable, but on the contrary, starts exercising some forms of control of its own on the economy, politics and policies.[1] Thus, on account of the sizeable and growing black sector, and its influence on the public policies, if on no other account, State interventions gradually move from the 'solution' vector to the problematic itself. Thus the State - the agency and instrument to deal with the black economy, finds its capacity to do the job constrained on account of the links of the 'problem' extending right upto the 'solution-agent.'

The 'disease' has afflicted the 'physician'.

On another view, the interaction between the compulsions faced by a State dominated by certain powerful resource-holding classes in the process of catalysing development on the one hand, and the compulsions of competitive electoral politics on the other create a framework of mutual dependencies and feedbacks linking business and industry through a number of formal and informal processes.[2] If the State has to combine direct participation in the economy (mainly in the form of creation and operation of economic assets) with an extensive regime of controls, regulation and promotion of private economic activities, its relationship with business and industry becomes very close and complex. For example the needs of resource mobilisation for the former task may conflict with the promotional policies directed at private enterprise.

While there are many issues of general attitude and policies towards private economic activities, there also crop up issues of deciding approaches, policies and actions concerning specific industries, industrial houses and firms.[3] The Report of the ILPIC (Government of India,

New Delhi) shows instances both of general and of specific kind in which the relationship between government and business changed from those contained in the declarations of the Industrial Policy Resolution of 1956.[4] The Report of the Mundhara Commission may be taken to represent how the processes work in specific cases.[5] In this process, many conflicting needs, tensions and pressures build up in the system. The resolution of these conflicts, tensions and pressures becomes a matter not only of legitimate political processes, but also of many hidden, illegal and subterranean processes. Both in the overt political processes and underhand manoeuvrings, availability of black incomes becomes a powerful means for intervention for general and specific purposes. Hence the relatively autonomous power and manoeuvrability of the black sector becomes, to a certain extent, a challenge and a meance to the established and legitimate political power, though the latter may owe its position, at least partially, to the patronage extended to it by the black sector.

Thus the black sector may owe its position and strength to various dispensations of political authority at the same time when it is also participating in the process of distribution of political power.[6] Similarly,

the political strata receive patronage from and dispense patronage to the operators in the black sector. They are each others benefactors as well as beneficiaries. Eversince the banning of open "donations" by the large and concentrated corporate sector to the coffers of political parties, the role of and need for the black sector in this arena has increased considerably. A large number of other changes in politics (like its increasing divorce from basic issues of policies, programmes and strategies).[7] and economy (like watering down of initial policies concerning self-reliant Planning, public sector etc. in order to deal with growing contradictions inhibiting growth and jeopardising development,[8] also contribute to this outcome. What is implied is that following from the strengthening of the propertied entrepreneurial/managerial classes in the wake of State-sponsored expansion of the economy, politics is increasingly involving conflicts for hegemony by specific combinations of the propertied classes. Thus it is various kinds of rural - agrarian, mercantile, industrial capitals, with their regional-linguistic, sectoral and commodity-wise and size-wise diversities which are, in quick-changing alignments, locked in a struggle for dominance. This largely intra-class politics tends to

become politics of money power. In the politics of money, obviously its most easily dispensable component - the black component - tends to take the front seat.

Following from this framework of the relationship between the black sector and the political system, it may be possible to have some inkling of the constraints which limit the conception, design and operation of various possible responses of the government to the black sector. The fact that this sector has grown to its present dimensions, turning a large patch of the economy into a grey economy, with its densely black and many optically or cosmetically white patches, and the fact that this character of the operational mechanism of the economy is an open secret, testify to the growing accomodation and reliance by the system on the operations of the black economy. The intermingling of the politics of black money and the business of generation and growth of black incomes is so deeprooted and widespread that it would be difficult to believe that the latter exists despite the political systems firm opposition to it.

The constraints do not arise from the political system and its functioning alone. Some specifically economic factors too contribute their part to inhibit the possibilities of controlling the black economy.

The intermingling of the unaccounted and accounted activities and transactions makes it difficult to identify the area which is to be restricted and curbed. If the legal and the black economies were two separately marked out, parallel economies, one would at least know the areas on which there is the need for clamping down with a heavy hand. But given the closely, intermingled character of the two and the fact that the private sector has been assigned a large and growing role (at least in an absolute sense), with the state providing to it supporting facilities and framework, the dilemmas faced in controlling the black sector become rather acute. It becomes very difficult to promote the expansion of legitimate economic activities by curbing the black activities when the former is tied in innumerable knots with the unaccountable activities.

A large number of fiscal incentives, like investment allowance, tax holiday, development rebate, etc. are offered in India for encouraging industrial development.

In the case of investment allowance, all industries except those specified in the eleventh schedule to the Income Tax Act are eligible to avail of this incentive. Starting from 33 such low-priority industries, the number of such industry-groups has been brought down to 15 in 1981. Though the criteria for assigning low priority to certain industries has not been stated, nor does it seem possible to infer them by examining the list, it is clear that the suspected extent of black income generation in a particular industry or its relationship with the black sector as buyer or supplier does not seen to have been a criterion in extending or denying this incentive. Actually, the intermixing of legitimate and black activities and transactions make it very difficult to introduce such a differentiation. Thus, e.g. industries like glazed and mosaic tiles, crockery and cutlery, refigerating and air-conditioning appliances, watches, motorcars, chinaware and porcelainware, etc. are not considered low priority ones, though they can reasonably be expected to attract a lot of black spending. On the other hand, tooth powder and dental creams, soap, bidis, office machines and typewriters, etc. which may not hold any special attraction for black incomes are listed as low-priority industries.

The impact of many draconian controls operates not only on the real and circulation spheres but also operates through business sentiments and the structure and efficacy of incentives. Many inputs, much finance and a good deal of markets are made available by the black sector. The fact of these linkages with the black sector make many of the decisions for expansion (whether induced by market forces or by public policy) worth their while. Thus whatever growth, expansion and diversification one witnesses in the private sector owes considerably to the existence of a blooming black sector. That is to say, howsoever adversely one may judge or view the black sector, as far as the private sector is concerned, to them the black economy is an indispensable operational mechanism and prop. It is the sector which ensures rates of return considered adequate in a framework where the law of average rate of profit is operative and merchant capital and usury provide very high rates of return. Simply because the law does not recognise or legitimise this segment of their operations ensuring acceptable rates of return does not invalidate or nullify the need for such activities to them. In any case, we have seen how the political system also finds a modus vivendi with the black and the inter-mixed grey economy. Thus,

one may conclude that some of the constraints limiting the desire and need for cubing the black economy arise from its objective economic character in so far as the Indian private sector is concerned.

Since force, fraud and informality are basic to the functioning of the unaccounted sphere of economic activities, it becomes difficult to incorporate it within the formal models of the legal economy. Given this, it is to be expected that there will be a good deal of absence of data and lack of appropriate understanding concerning the black sector. As a result, not only the magnitude and mechanism of the black economy are little understood, but one also fails to grasp how extensive and intimate its links are with the rest of the system. These factors also act as some constraints on the processes of dealing with the black incomes.

A quantitative growth by itself is an important prerequisite for an uninterrupted functioning of a private enterprise economy. Given the inter-mixed activities obtaining in India, growth of private economic activities necessarily entails expansion of black operations, (the rates of growth of private sector incomes and black incomes

seem to operationally correlated) as sources for funds, real resources and for ensuring operationally attractive rates of return. Clamping down on the black sector may disturb the actual conduits and mechanisms for expansion of private economic activities. This may conflict with stated and actual preferences about the institutional structure of the economy and pursuit of growth and modernization, even if one ignores for the moment the associated questions of interests and power-equations. Thus the rigid, ideological (as opposed to functional criteria of historical feasibility) conception of what has come to be called the Indian mixed economy limits the possibilities of doing away with the black sector.

It would be simple mindedness of an extra-ordinary order to presume that removing the black sector would be just a cleansing operation essential for restoring the economy to a healthy road of legality. It is not implied that nothing can or need be done about the black operations. We have seen how these activities create many complications in the economy and polity in many different forms. However, controlling the black operations by attempting to put it under leash is not the same thing as its total elimination.

The most difficult and tricky questions is : how far and how can one keep the black sector under certain limits of tolerance as an essential, if openly unacknowledged, instrumentality when its own inherent drive, like that of capital in general, is to continue to expand - this is its Moses and the Prophet.

As things are, surpluses originate in the hands which control property. Surpluses move into as well as origiante from the black sector. Moreover the self-expansion of such surpluses permitted outside the black sector does not provide adequate incentives for it to continue with its natural drives. On the other hand, the ruling policy preference seeking growth of GNP (for it provides the home market essential for capitalist growth) depends so heavily on private surpluses. Hence changing property relations, transferring control over property from private to public hands, is quite naturally a policy choice of the last resort and to a limited extent only for Indian economic policy. Given these constraints, some measures may either reduce the quantum of black resources and/or close certain channels available to it. The basic essentials of the phenomenon survive. Hence it recurs, in changed forms and larger magnitudes. Like many other things, while one

learns to live with it, one has periodically to move against it as well. Since there are hardly any inherent non-control sphere internal checks and balances putting an end to its self-expansion, some public policy checks and controls become essential to restrain the black sector.

These processes of successive serious eruptions and efforts at restraining the black sector are a part and parcel of the process of emergence and resolution of various contradictions in the economic and political system. It is linked up with the overall dialectic of the system. Hence an analysis of the questions connected with the black sector cannot by itself provide complete answers to these long-term questions. On the contrary, it is these long-term processes which would circumscribe the cycle of growth and expansion and control of the black economy. For example, if there persists a period of lack of direction and undecisiveness in the political economy of India, the processes of black economy may not be curtailed but just be regularised and accepted as a part of the game, so long as the black resources became available to finance public spending as withnessed in the special bearer bonds scheme, 1981.

In sum, since curtailing black economy slows down 'growth', weakens incentives for expansion of private investment on account of lower rates of permissible post-tax returns, closes some sources for funds, and inputs needed for expansion, reduces the consumption of many luxuries which provide a spur to private efforts and initiative, build up pressures to look for non-private sector agencies for growth and thus conflict with preferred choice parameters, the drive for eradicating black economy cannot be taken up very effectively. Only a limited effort to keep it within manageable dimensions is likely to be made during periods when its size distribution and mischief tends to threaten the balance of forces in a destablising manner excessively compromising the relative autonomy of the state. The objective of such interventions cannot be to do away with the black sector altogether, - it is neither feasible nor, from the point of view of the dominant classes, desirable.

At this stage, a question might be raised that while tax evasion on a certain scale is almost universal in societies where direct taxes on income and wealth are at high rates and form important part of the fiscal structure, why is that the black sector has become so

pervasive, worrysome and significant in the Indian economic system? To begin with, the clamour about the black sector is not unmistakable indicator of its size, it may have more to do with it consequences. However, there are some reasonable bases for expecting the black sector in India to be a far more serious phenomenon - both in term of its size and consequences - than in many other market economies - particularly developed capitalist economies, which at their present stage of development, many have greater capacity to live with it.

At the most fundamental level, the phenomenon of black economy owes its origin to a sharp discrepancy between the legally permissible post-tax rates of return and the generally acceptable, adequate and feasible rates of return. If the above provides the motivation to look for black incomes, the existence of a large number of untaxed or lower taxed and unorganised activities and the specific nature of the relationships between the control sphere on the one hand and the real and circulation spheres on the other provide the means for the genesis and proliferation of black incomes.

The high level of acceptable net rates of return in a country like India arises, for the most part, on account of high rates of return in trade and money lending and their impact on generally expected rates of return. There are many historical reasons for the existence of a widespread informal sector in India. Similar reasons explain the lower rates of taxation applicable to agriculture and allied activies.

In contrast to the expected high rates of return, there are many factors which depress the actual, realized rates of return, Particularly in the sphere of industrial investments. The fact that for many goods the market in India is small, technology and many intermediate inputs are imported and export markets is not easily available tend to depress the likely rate of return on investments. The social compulsions of resource mobilization and reducing unbearable and unconscionable inequalities of wealth and income also make for relatively high rates of taxation. Reliance on constently rising marginal rate of saving as a means for the increasing the average rate of saving also tends to being about higher rates of direct taxes because it is essential for increasing public savings.

The Kaldorian package of tax-measures has, by and large, been introduced in order ostensibly to promote growth and equity. This reduces the carry home rates of return on investments. The importance of non-agricultural goods in the average consumption basket is relatively low and is largely confined to traditional items like textiles, edible oil matches, sugar etc. In these traditional industries, taking a good part of the consumption expenditure of the masses, the rates of return are low and industrial sickness rampant. A complex of such factors create a good deal of discrepancy between the permissible and expected rates of return, giving a big fillip to the phenomenon of the black sector.

Then the phenomenon of colonial expoitation and metropolitan-peripheral relationships have contributed to sustaining and maintaining the rates of return in the First World, which are not available to the capitals in the Third World countries like India, though some of her larger monopoly houses are branching out into other countries to obtain and/or maintain relatively higher rates of return. The handicaps are sought to be made up by going in for black transactions.

The persistence of the black sector in order to ensure higher rates of return in India is supported by another feature witnessed here. Metropolitan capitalist development, in which competitive Schumpetarian processes of creatife destruction operated, led to destruction of earlier economic forms and their replacement by newer lines of production. Thus the pursuit of profits and expanded reproduction produced larger employment, increased production of mass consumption goods, increased labour productivity and rising standards of living. That is to say, there arose a certain degree of correspondence, at least within the metropolitan countries between private and social gains on account of sizeable and sestained rates of growth of income and employment. This lead to a certain degree of muting of the voices pointing to phenomena like tax evasion and its proliferation in the developed market economies.

But in countries like India where colonial and post-colonial capitalist development is unable to produce its 'social dual' (i.e. correspondence between public and private good because of the failure of capitalism to generate in adequate measure employment, incomes, mass

consumption goods and rising standard of living), and because political development in some senses keeps ahead of economic development, it is not surprising that there is more strindent clamour about the black sector and its expansion. Thus, despite the hue and cry about the black sector, its role in the system and its power put certain sharply identifiable limits on various efforts meant to curb it. In fact, if our analysis is valid, it will follow that the objective of elimination of the black sector is not likely to be set up or accepted by public policy. However, the inherent tendency for the self-expansion of black incomes and wealth produces various kinds of pressures to bring it under some control and put a certain amount of control on its operations.

It is possible to reduce the extent of on-going tax-evasion, i.e. simple black incomes, in a number of ways. A number of policies, programmes, laws and administrative steps can reduce compound black incomes which fall predominantly in the black sector. However, that category of compound black incomes which arise in association with legal, economic activities and transactions, through under and over-invoicing or through commissions, cuts and kick backs, are about the most intractable,

especially at the level of policies, (except, of course, through the ones which are of relatively more fundamental type infringing on private property and enterprise). Similarly, political black incomes can be reduced only to a limited extent through changes in political and constitutional structure (like electoral reforms, formalisation of the role of business and industry in politics) and through those changes in politics which bring the masses increasingly into politics. The foregoing analysis, therefore enables us to set a somewhat clearer perspective about the possibilities of various kinds of public policy responses to the black economy encompassing objectives, policy variables and their operational mechanism.

IV

Notes

1. See, Frankel, F. India's Political Economy 1947-77. The Gradual Revolution. OUP, Delhi, 1978. pp.475-476 on the role of "black money". She writes, "By 1972, although direct verification was impossible, it was believed that the Congress Party and the Prime Minister personally had become the main recipients of illegal contributions by the larger business houses (in response to political blackmail implicit in threats of nationalization), and from leading smugglers (in return for political protection over a wide range of illegal transactions) that sparked ramours of growing ties between the government and "black professions" of the under-world". pp.475-476. Gold auctions and many other steps taken by the Janta Government make the same analysis is applicable to the Janta government 1977-80. Also, see, Kothari, Rajni, "Democratic Polity and Social Change in India. Crisis and Opportunities. Allied, Bombay, 1976. pp.28-32. "In recent years this aspect has acquired increasing significance and has made politics, somewhat on the lines of what has happened in the United States, a preserve either of the rich or those patronized by the rich. It has placed disproportionate power in the hands of political financiers (largely from private industry) and of those who can manage to get money from such financiers. This money is needed both for winning elections and, therefore, for consolidating - or dislodging - the ruling group within the majority party. It is also needed for the day-to-day running of the party organisation. In short, it is an essential element of the electoral, legislative, and party politics." p.29. However the causal importance for this phenomenon which Kothari assigns to "distances between the representatives and the people they represent" does not only seem to be disproportionate but also tends to negate the role of positive strivings by private industry and black economy operators to subjugate and control the political and administrative processes.

2. Kothari, Rani, Op.cit p.31 says "For despite the 'one man, one vote" theory, the present system has given rise to deeply-entrenched interests on whom

public figures have become increasingly dependent, thanks to politics being treated as private enterprise in which illegal and unauthorized money becomes the principal currency. As this happens, the manipulative aspect of politics gain, further in proportion as the participant aspect loses."

3. See Chenoy, Kamal A.M. Industrial Policy and Big Business in India - A Case study of FICCI-1947-1966 (Manuscript of a Ph.D. Thesis to be submitted to Jawaharlal Nehru University, New Delhi). Kochanek, S. <u>Business and Politics in India,</u> University of California Press, Berkelay, 1974. pp.214-239 for the relationship of Politics, Elections and Business with each other. Also Fadia, B. <u>Pressure Groups in Indian Politics</u>, Radiant, New Delhi, 1980

4. Goyal, S.K. <u>Monopoly Capital and Public Policy. Business and Economic Power</u>. Allied, New Delhi 1979. pp.105-108.

5. Mundhara Enquiry: The Full Story. <u>Free Press Journal</u>, Jan-Feb. 1958.

6. Many studies of the political processes in India make this point. For instance, Kothari, Rajni, <u>Op.cit.</u> and references cited in it. pp.24-32. For the linkages starting from the village level onwards, see Sirsikar, V.N., <u>The Uncrowned Rulers of India.</u>

7. As Frankel, <u>Op.cit.</u> p.577, says, "Yet, if it is by now well-established that competitive politics over the past twenty-five years has succeeded in creating "a critical level of political awareness" among the illiterate and the impoverished, it is equally apparent that this heightened political consciousness has not yet resulted in the application of effective popular pressure from below to carry out peaceful implementation of social reform." Kothari, Rajni,

Op.cit. pp.16-21, attributes this consequence to the "hiatus between the aggregative and disaggregative performance" which led to "the failure to give social content to democracy." He argues that it was not recognized that "there were built in constraints on the progression from aggregative to distributive performance."

8. Since these changes are coming about in an incremental, piecemeal manner, are of recent vintage and the process is still on, no comprehensive survey and analysis of these trends has come to my notice. However, current writings in economic and financial press highlight these shifts in policies, increasingly confirming to the policy prescriptions of the World Bank and its affiliates. In a general way the policy chapter of Sixth Five Year Plan 1980-85 GOI, Planning Commission, 1981 gives ample indications of such shifts in the policy perspective.
Also see, Kamat, A.R. "Congress Drifts to the Right (Business Standard, 11 Sept.'81) and "The Morass of Economic Crisis." Business Standard, 18 Sept.'81.

Policy Framework: Myths concerning Controls and High Tax Rates

For dealing with a complex and multifaceted problem, like that of the black economy, there has to be an integrated policy-package consisting of many different components. Apart from such a specific policy-mix, almost all the policies which the State introduces over a given period of time must be examined from the point of view of its relation with the impact on the black economy. That is to say, every policy must be reviewed for its effects on each of the following specific aspects: unearthing black money, preventing tax-evasion, reducing or eliminating channels for further use or legal or otherwise laundering of black incomes. It is also imperative to examine the effects of each public policy on the basic factors which impinge on the black sector like divergence between the acceptable and post-tax realized rates of return, existence of a sizeable informal sector as well as activities which are either tax-exempt or attract differential rates of taxation, symbiotic relation between the political processes and the black sector and, last but not the least, the informal adjustments to various controls on private enterprise, market and price-mechanism

which is
for regulated/growth brought about by the black economy operations.

The upshot of the foregoing is that the policies for dealing with the black sector cannot be evolved in isolation from the general framework of socio-economic policies. After all, the black economy comes into being and grows as a result of a specific form of interaction between the control sphere of the economy on the one hand, and, the real and circulation spheres on the other. Therefore, methods of dealing with the black sector must take a very close look at the rationale, contents, form and methods of operation of the control sphere (i.e., economic planning, policies and economic administration) in order to see how it impinges on the basic factors responsible for the black sector. A new strain of economic and political interventions designed to deal with what resulted from earlier decisions concerning the same sphere would obviously be inadequately effective, or may even be defeated, if suitable and consistent modifications are not made in the latter.

Since the black sector owes itself to the specific form, contents, and size of the control sphere in its relationship with the real and circulation spheres, a facile and simplistic view has often been advocated that the best response to its menacing proportions and consequences is to dismentle the control sphere either totally or substantially. Such views are based either on the inherently uncontrollable nature of the market economy or on the inherent efficiency on the governments to enforce the requisite controls. As Albert I. Sommers maintains, "The collective 'beneficence', for which the responsibility has fallen to government, is inherently inefficient. Far from controlling itself through the equilibrium process of a market, its 'beneficence' may be destructively cumulative whenever its efforts impair market balance and incentives." ("Ends and Means: Market Vs. Government" in Economic Impact, 1980/2, p.74).

The groups who make this demand most stridently are easily identifiable. Among professional economists, it is a sub-group of those who identify the economy with the market and consider the latter, both in terms of outcomes and as processes by definition, efficient* and who blame the

*As Albert T. Sommers (op.cit..73) puts it, "Whatever it (the market) does is right, by virtue of having done it, in much the same way that whatever nature does is right."

black economy alongwith other inefficiencies (or the black economy as an epitome of inefficiency) on the existence of controls and regulation. They are joined in by a large number of business and industry groups and their political supporters in propagating this view.

Since it is controls of various descriptions which bring about a divergence between acceptable and allowed rates of return and limit, curtail, modify or proscribe certain activities, it is a tautology that controls breed black economy. It implies that certain activities are black, not by themselves, but with reference to certain controls and laws. What is not realized in this kind of polemic is that if the uncontrolled market processes and outcomes were acceptable in the first place, a regime of controls would not have been introduced. This aspect, i.e. non-acceptability of unrestrained market processes, even by those who oppose controls and regulation is often lost sight of.[1]

Thus, it is not controls, but the inability to effectively ensure and enforce their intent, then, which breeds the black economy. Similarly, doing away with controls does not substantially alter anything, except

that it removes the label of illegality or penumbra of disapprobation from certain processes. To argue that controls not only "cause" (in the sense of not allowing as legitimate) operations which generate black incomes but also increase and multiply black income operations is to take a static view of a dynamic process. It is true that once having come into being, black incomes multiply. But in the event of certain activities and processes not being curtailed, restrained or proscribed through controls i.e., not being dubbed 'black', they will not continue to remain static at any given initial level. They too will expand in much same way that the black operations expand. In effect, it may be possible in certain cases, that without the loss of legitimacy, such activities and processes would have accelerated at a faster pace. It follows that this tirade against controls as being responsible for the black economy is a tautology and completely misplaced. If removing controls can eliminate black incomes, then crime too can possibly be abolished by abolishing all laws!

There is another group of economists who recognise the need for applying controls over the market processes. Their reasons for it are basically technical, like

indivisibilities external economies, public and semi-public goods, merit and demerit goods, unequal national strengths in international markets, increasing returns, deficiency of aggregate effective demand, various informational bottlenecks and their consequences, disturbances caused by the monetary and credit system, etc. What they oppose and resent are not controls as such, but direct and physical controls, i.e. controls which replace or do away with market processes, (rather than modifying and/or supplementing the latter) which in their view, are essentially efficient except some limiting and/or distorting factors. They support or accept controls which work through the price and market system like taxes, subsidies, etc.

To the extent even such controls lead to tax-evasion and operations of the black economy, they advocate stern administrative-legal methods of dealing with them; but largely they accept the evasions as inevitable and advocate learning to live with them as is the case with the developed market economies. After all, if it were possible to ensure a one hundred percent compliance with laws, then perhaps the need not even enact the laws, with penal provisions, but just instruct people in what may be called 'legal behaviour'. Hence, ignoring such

non-compliance as marginal, the essential case is as follows: The indirect controls are expected to operate through changing private profitability (both positively and negatively) according to some social dictates. Except for the minimum of such indirect, market based controls, the rest, according to them, are bound to be counter productive or redundant, because the objective market forces would find many ways (like black marketing, corruption, political black incomes, etc.) to frustrate the direct and physical controls.

These views on controls do not recognise many serious sources of market failure, where incremental intervention would be grossly inadequate. Even, in the developed market economies, the problems of ecological imbalances and pollution, coexistence of private wealth and public squalor, stagflation, growing inequalities within and between nations, sustaining traditional sectors like agriculture, shorting up the fortunes of older industrial areas, etc. are considered too sticky and intractable by a regime of price-mechanism based marginal interventions. This limitation is more particularly relevant in the developing economies needing large and growing public investment and structural changes as the most critical, catalytic interventions, even for making

the market forces to work and encompass the entire economy.[1] Then, the fiscal implications of raising resources for supporting state interventions and direct participation for expanding and deepening the control sphere generate a snow balling process of strengthening controls.[2] The unannounced jump that the economists of this persuation make from their text-book economics and formal models to the real life situations comes in the way of their perception of the nature, role, scope and intensity of controls required in modern economies. It is a stubborn carrying of the baggage collected in the past on a journey to a different destination!

Thus the problem of controlling black incomes is not a simple one of either doing away with controls altogether (including sizeable cuts in tax-rates) or restricting and simplifying controls. In the process of dealing with a secondary complication (i.e., the black sector) which arises in the course of dealing with the primary malaise and complaints developing in a private enterprise, market economy through a regime of complex controls, one cannot afford to wish away the primary malady to which an intricate system of controls and

regulation is, after all, a response.[3]

A specific variant of the above arguments is one which relates black incomes and tax evasion to 'high rates of taxation'.[4] The argument can run along two lines. One, high rates of taxation causes black incomes, because people do not wish to pay such huge sums in taxes. Second, it is suggested that the higher the rate of a tax, the more attractive it is to evade/avoid it and the more worthwhile is the risk associated with such tax evasion.

The Direct Taxes Enquiry Committee (Op.cit, p.9) found a great deal of support for this view. It said, "When the marginal rate of taxation is as high as 97.75 percent, the net profit on concealment can be as high as 4,300 percent of the after-tax income. The implication of 97.75 percent income-tax is that it is more profitable at a certain level of income to evade tax on Rs.30 than to earn honestly Rs.1000."

It has further been suggested that tax-rates approaching confiscatory levels erode the legitimacy of taxation and imparts to tax-evasion "the status of a

defensive weapon in the hands of tax-payers." (DTEC Report, pp.18-19)[5] For example, if the high marginal rates of income tax are clubbed together with wealth tax, it may be possible that at certain ranges of income and wealth, the combined tax outgo may exceed 100 percent of current income, i.e. one has to dissave in order to pay up the tax liability honestly.

In so far as the basis for unofficial or black incomes is to be found in the dissatisfaction with the past-tax rates of return, it is obvious that the phenomenon relates to taxation. Since taxation is necessary for the creation of black incomes, it is obvious that tax-evasion can be abolished if taxation is abolished. At the zero rate of tax, there will be no need to evade any tax!

Since the tax liability is supposed to be higher at higher tax rates, the scope for tax evasion increases with tax rates. Even if a constant proportion of tax-liability is evaded at relatively higher rates. However, this is a tautology. To be meaningul, the proposition relating tax evasion to directly to tax rates should mean that <u>at higher rates, prospects of greater gain induces greater propensity to evade.</u>[6]

That is, if someone were evading 20 percent tax at 30 percent tax rate, he would evade, let us say 40 percent or greater percentage of tax at 60 percent tax rate. That is to say, the amount of tax evasion rises at least proportionately or more than proportionately with rising tax rates.

However, to make tax evasion predominantly a function of marginal tax rates is to oversimplify a complex decision dependent on money factors. If the relationship were so simple and direct, it would follow that at a certain positive and high rate of taxation, no taxes would be paid, (not through disincentive effects as implied in the laffer curve,) but through unwillingness to pay taxes i.e. through tax avoidence/evasion.

In fact, even the argument that at a 100 percent tax rate, there will be no revenue is a very dubious one. For one thing, it is not a flat rate of 100 percent tax which would be the choice of any rational finance minister. Unless consumption and investment are socialised, it would be absurd to think of a 100 percent flat rate of income tax. In that case, there are no money incomes

available to individuals which can be taxed. However, it is possible to think of a situation when a country proposes to apply a ceiling on personal incomes through a 100 percent marginal rate of income tax at a certain level of income. At such a tax slab, the total tax revenue would be zero if the entire tax liability is evaded on lower income slabs as also only if the entire income falling in the highest slab is concealed. In order to concede the possibility of 100 percent tax evasion, one would have to assume away the government! Given the scale of property owner-ship capable of yielding such a high income, it is rather unlikely that the entire income can be evaded.

Actually, if there were a direct correlation between the extent of tax evasion and the tax rate, it would follow that tax evasion can be eliminated only when taxation is abolished. That is to say, since every organised, society needs government and hence taxation, tax evasion (simple black incomes) is inevitable in every organised society. Furthermore, if evasion continues for sometime, people accumulate black incomes and wealth, which would lead to profiferation of compound black incomes.

Even if simple black incomes (i.e. legal incomes on which tax is evaded) are related to tax rates, compound black incomes are not, which arises from huge accumulated simple black incomes and their subsequent use for earning further incomes. Compound black incomes fall totally outside the tax purview because their tainted origins preclude the possibility of paying taxes on them. Since compound black incomes for outweigh simple black incomes i.e., the flow of newly created black incomes through tax evasion on legal activities is only a fraction of compound black incomes), the major portion of black incomes is independent of the tax rate. Similarly, incomes received in the form of wages and salaries and also work incomes earned in the organised sector as regular contractual payments cannot be evaded, irrespective of the tax rates.

The hypothesis of direct quantitative correlation between tax-rate and the rate of tax-evasion would imply a certain tax-rate at which tax-evasion is at its maximum and a certain rate at which it is at its minimum. It would be very difficult to determine, whether on an a priori basis or empirically, a threshold rate of taxation

at which taxes are paid honestly without any evasion. Similarly, it is not possible to postulate a tax rate at which the entire tax is evaded; this is only possible if one simultaneously posits the maximum tax rate and no government! In any case, a flat rate of 100 percent income tax is possible only if consumption and investment are socialised. At such a maximum tax rate, with its necessary corellary of socialised consumption and investment are socialised. At such a maximum tax rate, with its necessary corellary of socialised consumption and investment, it would be very difficult to postulate 100 percent tax evasion, or even tax evasion of a substantial part of income.

This is so because a certain degree of weakening of the incentive to evade taxes may ensue from socialisation of consumption and investment. If it is so, it is a substantial weakening of the hypothesis of direct correlation between tax-rate and rate of tax-evasion. On the other hand, if tax-evasion on a substantial scale continues in response to 100 percent tax-rate and irrespective of the socialisation of consumption and investment, it amounts to jeopardisation of socialisation of consumption and

investment. The limiting cases in which the hypothesis of direct correlation between tax rate and rate of tax evasion breaks down is a substantial a priori refutation of the generality of the hypothesis.

The hypothesis of direct correlation between tax-rate and tax-evasion may refer to marginal rates of taxation. It would, then, imply that at lower marginal rates of taxation, the incidence of evasion is low and it rises with the increase in the marginal rate of taxation. The policy implication of the argument is that by lowering the marginal rate of taxes, one weakens the incentive to conceal incomes and evade taxes. Since the imposed higher rates of taxes tend to diverge from the effective, realised rates, it is argued that even from a revenue angle, it would be advisable to bring down the marginal rate of taxation. This would bridge the gap between the imposed and the realised rates of taxation, leading to either the same or even higher tax revenue.

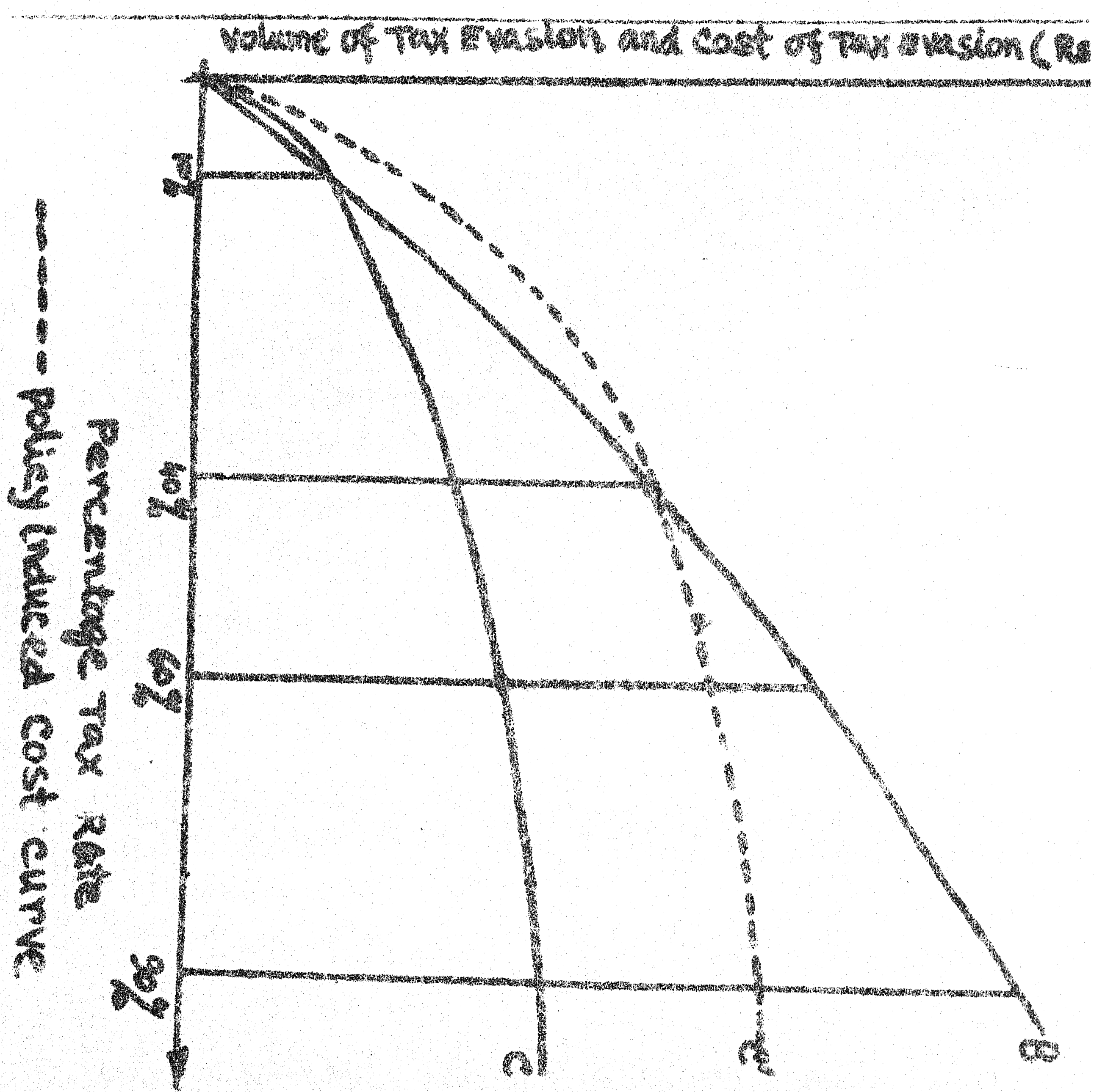
The basis of the above argument is evidently grounded in economic rationality and economic calculus. It relates the behaviour of rational economic agents to

the gains from tax-evasion. Since the gains from tax-evasion are higher at higher rates of taxes, the rate and volume of tax-evasion would be higher at the higher rate. If one reduces the tax-rates, it is contended, one reduces the gains from tax-evasion. Hence the policy-package for dealing with black incomes should include reducing the marginal rates of taxes.

The above argument would make sense, given the logic of economic rationality, if it were also assumed that there are only gains to be had from tax-evasion and it is either a 'costless' operation or its 'costs' are always less than 'benefits' and are furthermore either independent of the size of the operation tax-evasion (including the recurring costs of holding and carrying unaccounted incomes) or vary inversely with the latter.[7] As the Report on the Working Group of the Administrative Reforms Commission on Central Direct Taxes Administration puts it , "it is often forgotten that there is a cost even for evading and keeping evaded incomes and if the cost of evasion is higher than the gain from it, the rate of taxation by itself would not be a motivating factor causing evasion." (p.108, New Delhi, 1968).

The 'cost' evasion are basically of three types: costs of concealment, costs of holding concealed incomes and wealth and costs of avoiding detection. The total cost of evasion, then may change in very many different ways, depending on the behaviour and relative importance of these three elements. It is clear that all the above assumptions about the costs of tax-evasion are empirical assumptions. There is no reason to believe that the costs of tax-evasion are always less than the benefits available to the evaders, either in the short or in the long-run. However, if the nature of the State and bureaucracy is assumed or found to be such that, in practice, the cost of tax-evasion is small in relation to gains from it and it declines with growing volume of tax-evasion, then the nature of the argument changes.

A symbiotic relationship between the black sector and the political system generates a high degree of tolerance towards the black economy. It also denotes a well-developed system of devices and techniques for evading taxes and multiplication of blak incomes. Given the high degree of tolerance, a well-developed system of tax evasion and multiplication of compound black incomes and a relatively low cost of operating in the black


volume of Tax Evasion and Cost of Tax Evasion (Rs
Percentage Tax Rate
Policy Induced Cost Curve

economy, the gains from tax-evasion are offset rather marginally. In this kind of a situation, so long as there are net positive gains available from tax-evasion and related activities, these activities are likely to continue. Even at very low rates of taxes, there will be sizeable gains to be had by evading taxes rather than paying them. There will be little reason to expand the tax-base in response to lower tax-rates because, given relatively low costs involved in operating in the black economy, one would compare that which is payable with the alternative of not paying.[8]

We can illustrate this argument with the help of a diagram. Showing the volume of tax evasion and cost of tax evasion (both in monetary units) on the vertical axis and the percentage tax rate on the horizontal axis, we can plot one curve showing the gross benefits of tax-evasion (in terms of the amounts evaded) and another showing the costs involved, in tax-evasion. According to the hypothesis relating tax-evasion directly to tax-rates, the benefit or tax-evasion curve rises with the tax rate. The costs of tax-evasion are not related in the diagram with the

tax rate, but with various amounts of tax-evasion. The cost curve rises with the amount of tax-evasion, though less than proportionally (with absolute amount rising with the volume of tax-evasion). This is because the cost of concealing incomes, holding and operating black incomes and costs and risks of avoiding detection have some overhead elements, which lead to declining per unit value with rising scale of tax evasion.

It can be seen that in the initial phase, at low rates of taxes and low volume of tax evasion, the cots may outweigh benefits of evasion. But later on, the benefits increasingly outweigh costs. In the Indian case, it is our hypothesis that the costs are not only very low, but, at higher ranges of evasion, they nearly become constant. In such a situation, even at low rates of taxes, there will be substantial tax evasion. The decline in the volume of tax evasion which may come about at the lower rates would be insignificant in comparison to the reduction in tax-rate. On the other hand, if the cost of tax evasion is increased to the positions shown by the dotted cost curve, one would see that a substantial part of tax evasion would evaporate, without causing a

fall in tax revenue or having to sacrifice other objectives sought through high marginal tax rates. Hence, the benefits of tax evasion are relevant only in relation to costs of evasion and, in the face of low costs, which are virtually negligible even at low tax rates, there is likely to be substantial tax evasion in a relative sense.

That is to say, given low costs of tax evasion, high level of tolerance of it, the skills at tax-evasion and easy and plentiful availability of devices for the purpose, the gains to be compared by paying or evading taxes would only remotely relate to the rate of taxation. The size of the gains from evasion are attractive even at low rates of taxes, because compared to the volume of the gain, there are insignificant offsetting costs. Hence, it is naive to presume that the taxpayers compare existing tax rate with an either a future, potential higher tax rate or a past, actual rate, in order to determine the extent of tax evasion. As far as an individual tax payer is concerned, he is likely to treat the tax rate as an exogenous variable, independent of his behaviour regarding the extent of compliance with tax laws. The major consideration, based on economic calculus, is likely to be a comparison between gains from paying and not paying

taxes and the costs and risks involved in doing this rather than concerning the rate of taxation. Since in India a tax-evader is beyond a break-even point even at very low-rates of taxation (because the costs and risks are low), the tax rate becomes an unimportant factor in the marginal decision about tax-payment or evasion.

In other words, the relevant marginal decision span about tax-evasion is not a narrow space sandwiched between a certain rate of gain (based on a certain tax-rate) and a certain rate of loss (based on costs of tax-evasion), but stretches over a wide space covering many different tax-rates. Given the insignificance of the cost of tax-evasion, the relevant comparison, at almost all practical tax-slabs and tax-rates, is between the volume of tax-payment and its "saving" if the tax is successfully evaded. This comparison is, for most potential tax-payers at most income levels, and at most of the tax-rates, in the absence of deterrant costs, a comparison unmistakably pointing to non-payment as the preferred or the desired option. Since the choice does not involve countervailing risks and costs which are a sufficient counterweight, taxes are evaded not so much on the basis of tax-rates but on the basis of the

attractiveness of the volume of tax-evasion, which remains operationally significant even at low tax rates.

Actually the major motivation of businessman, following from considering tax-payment as an element of the cost-structure, would be closer to some kind of minimisation of tax-liability in its absolute volume rather than to minimise or reduce black incomes by concealing a lower amount of incomes in response to lower tax-rates. The latter can become an important criterion in their calculations if the costs and risks associated with tax-evasion were significant. Thus in the present Indian context, it may be suggested that it is unlikely that the tax-evasion and black economy operations derive - significantly from the obtaining tax-rates, which in any case are not as high as they appear on the surface owing to a large number of deductions and exemptions which are permitted. In fact, since 1974-75, the tax-rates have been sizeably cut in India, though there is no evidence that the black economy operations and tax-evasion have come down.

A good many official studies have supported the above view. The Direct Taxes Administration Enquiry Committee held the view that the tax rates by themselves are not to blame for largescale tax-evasion in the country. The Working Group of the Administrative Reforms Commission on Central Direct Taxes Administration (Op.cit., p.108) maintained that, "A study of the figures of detected concealed incomes shows that at least in India, an increase in the rate of taxation was not followed by an increase in the tax-evasion nor a decrease in the rate has brought about a higher tax responsiveness."

In view of the above, it is important to attempt an examination of the factors which might have swayed the Direct Taxes Enquiry Committee to the position that black incomes are closely related to high rates of taxation. It said, "we are convinced that high marginal rates of taxation are a powerful contributory factor towards evasion in as much as they make the fruits of evasion so attractive that a less scrupulour person would consider the incidental risks worth taking." (p.19). The main argument given by the committee relate to "disincentive to productive effort and higher earnings" produced by high marginal rates of taxation. In so far as the equity effect of such high rates is concerned, the committee

was of the view that tax-evasion nulifies this effect. This view, apparently is based on the conviction that high marginal tax rates cannot be enforced effectively. Hence, the equity argument for high marginal rates of taxation, according to the committee, does not stand in the way of its plea for lowering them down in the interest of higher tax responsiveness.

The argument making compliance with tax laws an inverse function of tax-rates is not the same as the argument making higher tax responsiveness (in terms of total tax revenue) a function of lower rates of taxation (through the incentive effect on the supply of efforts, savings and enterprise). While the former relates to concealment/non-concealment of the incomes earned for tax purposes, the latter refers to the level of earnings in response to incentives/disincentives produced by the structure and level of tax rates. Even if it is granted that lower tax rates provide a spur to higher earnings and thus expand the tax-base, leading to either less than proportionate reduction in tax revenue or even an increase in tax revenue, it is not the same thing as reduction in tax evasion. Out of the higher level of personal and business earnings associated with lower tax-rates, what is

going to be the proportion of incomes which is going to be declared for tax purposes is a separate question, which we have been depends not only on tax-rates but on a conjuncture of many diverse factors. These factors apart from tax-rates include costs and risks of tax evasion, form and source of income receipts, political and administrative level of tolerance of tax evasion, availability of devices for tax evasion and methods and prospects for the use of evaded incomes and wealth.

Hence it is misleading to treat the incentive effect of tax-rates as identical with its impact on the propensity to evade and the capability to evade the taxes. The Direct Taxes Enquiry Committee seems to have mixed up these two issues. In any case, it may also be mentioned in passing that even the presumption concerning the incentive effect of reduced rate of taxation is not so certain as it depends on a host of other factors like the weightage of tax rates in total cost structure, generally available and acceptable rates of return, general state of the economy, effect of other public policies, particularly on business prospects, etc.

The contribution of higher tax rates to tax-evasion is, at best, marginal and a lot many other factors may easily outweight its effect. Still, one comes across this argument being made very frequently and very powerfully. This gives one some reason to suspect that it is more a lobbying ploy than an argument seriously concerned with curbing the scale and intensity of the black economy operations. If higher tax rates were leading to more tax evasion, then, leaving aside a probable bad conscience and the costs of efforts at tax-evasion, generally, the higher income groups should end up with being better off with higher tax rates, than they would be with lower tax rates. More particularly so, if lower tax rates were to lead to higher tax revenue, which may mean lower post-tax incomes to the tax payers, through not necessarily if the incentive effects are positive. If the higher tax rates were really not causing much tax-hurt to those who are potentially subjected to these rates, one wonders why such concerted propaganda and lobbying against the policy of high marginal rate of taxation!

In sum, the importance given to high tax rates in the aetiology of black incomes id disproportionate, misleading and perhaps motivated, particularly from the point of view of relegating other, more effective factors to the background.

Let it be remembered that controls and taxation are thus the standards with reference to which incomes and activities are labelled 'black', those incomes which arise by violating and/or evading controls, and/or taxes, become, _ipso facto_ 'black' incomes. There is a certain legal framework in every society which defines non-permissible or illegal activities. _It is illegical to hold the laws governing economic activities themselves as constituting the reasons by people violate or evade the laws._ However, the nature of such controls and taxes need to be examined if either there is a widespread violation of the laws or if they are found to be suffering from poor enforceability. From a social point of view there may be an impeceable case for the enactment and enforcement of certain laws and controls, yet there may be strong forces operating at an individual level for their evasion or violation and this fact, by itself, may make enforcement a tame affair.

Such a lack of harmony in the legal (or control and taxation) sphere between the social and the individual perspectives becomes a factor making for illegal or black incomes. It becomes particularly relevant when the individual perspective may be based on fairly strong objective factors like the rules of games inherent in an economic system in its historical specificity, like the comparative structure of rates of return on property and investments, extent of relative scarcities for various goods and services, the relationship between the state and business etc.

Specifically in the present Indian case, the operation of market forces, not confined to the strictly economic sphere, but extending to politics and government, makes many laws concerning economic regulation, controls and taxation, nearly a dead letter, as also enfeebles the machinery for their enforcement and implementation. As a result, the actual outcomes of the economic processes is sharply at a variance from those intended by the stated policy frameworks. If such a situation is not found acceptable and is intended to be changed, there are two major options: either to whittle down controls and taxation to bring them in conformity with what the market forces

tolerate, and allow in actuality, or, to bring about some changes in the scope, intensity and power of market forces so that they become responsive to public control.

The intermediate options of doing something about more effective implementation, forcing some new and additional means of implementation and sharpening and redefinition of controls and tax laws have not been entirely exhausted. However, in the face of the basic economic forces, the scope for such intermediate arena for increasing effectiveness and reducing the wide chasm between the social and individual perspectives is limited.

However, under the prevailing socio-political parameters, the major area in which short-turn corrective action may be initiated lies in the intermediate zone. For one thing, not much has been done in this field. Second, in the face of dangers that the social perspective may be revised downwards to square better with the market and individual perspective, it is a positive achievement if the core of the social perspective may be retained and realized more effectively. Then, a fairly comprehensive set of measures, within those parameters, through sustained and successful implementation brings about some long-run forces and processes capable of giving a better fit between the social and market perspectives.

Therefore, we reject the "remove controls-reduce taxation" scholl as naire, misleading and motivated. On the contrary, we postulate possibilities of redefining controls and tax-laws in order to reduce the areas of wishful thinking and devise sets of measures consistent with the objectively feasible scheme of controls and taxation.

Any scheme of public intervention will comprise the following elements - objectives (short and long-run/or tactical and strategic), control variables, instrument variables, objects of control and agencies, sub-agencies and mechanisms of control. Being composed of these elements, a scheme of intervention (whether a policy, or a tax or subsidy proposal) relates in various ways to a large number of variables, processes and institutions in the economy. As the design of the intervention (a specific combination of the qualitative and quantitative dimensions of the five elements listed above) is expected to operates in a particular manner, it is based on certain assumptions about the inter-relationship among those elements, severally and collectively, and certain assumptions about the relationship of these elements with various elements in the rest of the economy. If the elements in

the rest of the economy which are outside the direct control sphere are more important than the elements in the policy design or if the former behave differently from the assumed behaviour, or if their behaviour has not been taken into account, the policy design is, to that extent, defective and may diverge the policy-outcomes from the policy-design in many unpredictable and unexpected ways. An analysis of this kind indicates the possibilities of successful adopting various controls, the extent to which various processes are controlable and the specific changes in the policy design in order to give it a direction and a thrust.

A scheme of controls must be subjected to such an analysis. Such a scrutiny of various already instituted and intended policy measures may show that simply on account of the social and political pressures for a certain set of objectives, their institution by itself cannot ensure their success. The compatibility of various interventions with the general processes operating in the economy and the general role of the objects of control must be examined.

For example, very high marginal rates of taxation may be required on account of the objective of equity. But if the fiscal instruments of equity are not made commensurate with the role of private savings and enterprise, then the existence of both possibilities and means for private savings and enterprise to expand will tend to frustrate the excessive reliance on marginal rates of taxation. Such tax rates can curb present high incomes, provided the future avenues for the use of such incomes and savings are blocked. It implies not only a redefinition of the role of private savings and investment, but also effective expenditure, wealth and inheritence tax in order to blunt the will to evade and block the avenues for the use and multiplication of undeclared incomes. If private savings and investments can be, and are sought to be, encouraged, without any ceiling and one can undertake any level of expenditure, then one provides every conceivable incentive for the defeat of the high marginal rates of taxation. In fact, if the impact of such processes on the political processes are taken into account, it becomes clear that such high marginal rates of taxation are tolerated mainly because they are non-operative. To assume that such tax-rates can be enforced in such an

economic environment through administrative-legal processes is to misread the nature both of the economic and administrative-political processes.

The general consideration which derives from the preceding model is that the policy processes as they are likely to operate in an economy must be analysed in order to judge the prospects for the interventions to proceed according to their design. If it allows more powerful forces to operate, while attempts to control some peripheral or consequential aspects, the objective logic would, in conjunction with the public intervention, change the form of the operations (like driving it underground or making it more into a separate 'black' or unannounced circuit). Thus controls and interv ntions cannot be judged simply by their obvious, announced intentions or or some a <u>priori</u> tendencies. Just as the abolition of controls and reduction of marginal rates of taxation cannot, by themselves, reduce black incomes alongwith producing the results which such interventions intended to produce, (or without sacrificing the results sought through controls) similarly continuing with the interventions or multiplying them would serve no purpose but to widen the gap between

intentions and actual outcomes. A realistic dual test of making the controls internally consistent and externally strong enough to counter the general tendencies built into the system is an essential precondition for a significant reduction in the size and significance of black operations. It will have the added advantage of making the system look what it is rather than carry a lable which is but a smokescreen.

V

NOTES

1. As an example of how indirect, price mechanism based controls fail to reduce or eliminate smuggling, it has been argued that "if black market transactions in foreign currency is tried to discourage by resorting to an upward adjustment of the official price of foreign currency, then it is unlikely to succeed in the Indian economy because in India the profitability of smuggling will always ensure profitability of the black market operations in exchange and imported commodities." (Sunanda Sen, "Smuggling, Exchange controls and Indian Economy", Economic and Political Weekly, February 1975 (Annual Number p.126). According to her, "the magnitude and the significance of the problem is likely to be much smaller when the State can control more effectively the roots of the evasive process - in particular when the state controls more effectively the distribution of income which will take care of the black market demand for the smuggled items." (p.216) (emphasis added)

2. Perhaps it is on account of such factors that it is maintained that, "A corrupted mixed economy is not likely to be reformed by measures which tend to take it back to a market solution. (Sunanda Sen, op.cit, p.216)

3. An extreme form of argument denies both the prospects of successful controls as also the possibilities of removal of control from the system. As Sunanda Sen argues, "The failure of the government's recent drive to curb smuggling is illustrative of the self-defeating nature of controls in partially planned economy .... Attempts to control such evasion through a manipulation of the instruments open to the State in a mixed economy are not likely to meet with much success unless the reforms are extensive enough to change the character of the State itself." (Ibid., p.205)

   The above fundamentalist view seems to take a naive, one-dimensional view of the State, in as much as it fails to recognise a need for partial, effective controls without necessarily changing the character of

the State in its essentials. In other words, it rules out scope for changes in economic pol cy contributing to change towards the character of the State, which must come about through purely non-economic (political and other kinds of) actions. The intra-class contractions and conflicts, the need to give a partial, limited push to development, reduce absolute poverty and impoverishment, etc. which argue a case for short term agenda of economic policy and priority changes are not recognised. According to this view not only a private property market economy, even if mixed, will continue to subsist under such crises and distortions, but except for purely non-economic, one-blow (non-reformist) methods, there are no ways of dealing with such crises and distortions. This perspective may be appropriate under certain specific, restrictive set of circumstances. However, in my view, presently we are far from such a situation. Hence even if controls are "extensive enough", are internally consistent and are relatively strong in comparicn to other objective forces operating in the system, they may make the economy perform better, not only in a narrow sense but also in a broad sense.

4. This often-advanced argument is generally based on the proposition that the higher is the tax rate, the stronger is the incentive to reduce the tax base by concealment of the base. As Kaldor, N. wrote, "India, like most western countries has been in the grip of a vicious circle as far as progressive taxation is concerned - evasion and avoidance by cutting down potential revenue, led to higher nominal rates of taxation and this, in turn, to further evasion and avoidance and still higher rates It is a vicious circle of charging more and more on less and less." (<u>Indian Tax Reform; Report of a Survey</u>. New Delhi, 1956) p.6.

5. Reflecting such an attitude in the extreme form is a view which maintains that "On the presumption that avoidance is inherently evil and that the needs of revenue are paramount, anti-avoidance has become an instrument for the erosion of law and for the stimulation of totalitarian attitudes and practices. If it is an evil at all, avoidance is a minor one. Anti-avoidance has become a major one" (Shanefield, A.A., <u>Op.cit</u>. p.384).

6. This implication of the proposition was sharply pointed out by Dasgupta, A.K. ("Tax Concession as a Remedy for Evasion", Economic and Political Weekly, Vol. IX. No. 22, June 1, 1974 (pp.875-876) in a comment on the reduction in marginal tax rates in 1974-75 Indian Union budget. He wrote, "while at 97.75 percent to tax is paid on the marginal slab by the highest income earners, at 77 percent they will be induced not to conceal their income and at least 77 percent of it will be in the hands of the government". (p.875)

7. As Dasgupta, A.K. (Op.cit. p.875) say, "tax evasion is a propensity born of greed. Like any other propensity it is restrained only in so far as the person having re-course to it has to pay a price. A tax evader runs the risk of being detected and punished. This risk is the measure of the price that he pays for the gain that he derives from non-payment of his dues. He would not consider it worthwhile taking the risk if it were higher than the amount he is called upon to pay." If the probability of detection were one out of every 10 at attempts, the minimum penalty should be at least more than 10 times the tax evaded.

8. As Balbir Singh (Op.cit. p.263) says, "Lowering the the rate is no guarantee of eliminating tax evasion. Whatever the tax rates, they will have to be implemented effectively" Gandhi, Ved P., has shown by empirical verification that the inverse relationship between income tax rate and the income tax base does not appear be true for the companies. Op.cit. p.139.

Unearthing Black Incomes and Wealth

Unearthing of black incomes and wealth is one of the major steps for controlling illegal undeclared economic activities. Designing policies for this purpose requires an understanding of various forms in which such accumulated black incomes are held.

Our exposition on the character of the black economy proceeded in terms of simple black incomes compound black incomes, and Political-administrative Black Incomes' which are a current income flow in the economy. However, the compound black incomes are connected with the accumulated stocks of black incomes coverted into an asset portofolio yielding current black incomes. This classification of black incomes, linked up with certain distinct processes, not only recognises the conventional distinction between a stock and a flow that but connects the flows and stocks in a feedback relationship with each other.

It goes further in another sense. The income-yielding character of black asset-holdings in association with the fungibility of black asset-holdings in association with the fungibility of black incomes retained in the form cash balances, points to the many inter-connections between

the black and the legal segments of the economy. Additionally, by the separate categorisation of political administrative black incomes, the nature of the black operations linking up the real and circulation spheres with the control sphere is highlighted.

It follows from the above analysis that the inter Penetration between the black and legal economies imarts to black incomes and wealth, forms which alternate between money and physical goods of diverse descriptions ranging from commodity stocks to intermediate and capital goods. That is to say, there is a circuit of black flows starting from BM (black money) and ending up with BM. The process of circulation of black money defines the size, froms and consequences of the black sector and its relationship with the legal economy.

It can be seen then that apart from a part of the accumulated black wealth which is kept in the form of cash-balances on account of security and speculative motives, there are also black cash-balances in the system on account of income and transactions motives. The major difference between black wealth kept in the form of cash balances on account of speculative and security motives

on the one hand and income and transactions motive on the other, is that while the former are generally without a counterpart of physical goods (except gold, jewellery, precious stones, etc.) the latter are constantly used in the process of buying and selling or acc-umulating and de-cummulating stocks of goods.

It means that the holders of black wealth in the form of cash balances continue to move from goods into cash and from cash into goods. At any given movement of time, then a part of the black wealth kept for speculation in money and capital markets and for security is not the only monetized component; even for the transactions financed out of black income accumulations, there is a cash counterpart which moves with relatively greater velocity. In fact, to the extent there is prevalent the practice of under-and over-invoicing in legal transactions, there is floating in the system in the form of cash a certain amount of black wealth. In other words, since a large number of transactions in the economy form a part of the black economy, its 'working capital' in the form of cash circulates in the system-moving from goods into cash and vice-versa. It means that effectively the total amount

of black money in the system is much more than the amount amount hoarded in the form of money. In fact, since black incomes are also entering the banking system in the form of fixed deposits and deposits in savings accounts opened in the name of minors, and benamis, (fictitious and undeclared accounts), there is another liquid form in which black incomes can be found.

Thus the quantity of black money in circulation may be sizeable at any given moment of time. This does not follow from the fact that it is difficult for black incomes and wealth to take 'visible' forms as the black operators supposedly cannot afford to hold visible financial assets (as suggested by Sundaram and Pandit, Op.cit. pp.145-147). As we have suggested, a good part of accumulated black incomes are found in the form of cash owing to its use as working capital to finance wholly or partly black transactions. Even in visible financial assets like bank deposits and shares, a not inconsiderable amount of black incomes are held. There has also developed a marked in the black-wealth financed financial assets - both visible and invisible (fictitious IOUs and havalas), which also necessitates recourse to cash balances.

It is true that a good part of accumulated black incomes find outlets in real estate and immovables. Gold, silver, precious stones and jewellary are also strong contenders for the use of accumulated black incomes. Such forms are not adopted simply because of convenience of concealment and capital appreciation. There has developed a ready market in these assets and a combination of security and pecuniary gain motives impel transactions in these assets, particularly in view of constantly rising trend in their prices. Thus real estate and precious goods use of black incomes and wealth does not lead to curtailment of the role of money by an equal amount for many reasons. For one, there has developed a ready underground market for these assets. Second, the supplier in these markets conceal the bulk of their incomes hold them in the form of cash and operate at an undergound level and lastly, the newly emerging flows as well as accumulated black incomes are constantly used for buying these assets. That is to say, there is a certain amount of money circulating in the black markets for real estate and bullion in which whole some moves into these goods, other move out of them.

Therefore, it can be concluded that irrespective of many forms in which black incomes and wealth are unverted, there are sizeable quantities of money floating in the black economy. This fact underlines the important of demonetization of higher denomination currency as a means for unearthing as well as cancelling out a good part of black incomes.

Demonetisation of high denomination currenty involves derecognition of such currency as legal tender and replacement of those parts of the cancelled currency by legal tender as can legitimately be accounted for. Thus all the unaccountable money held in high value currency notes become null and void. It is misleading to presume "that holders of such liquid assets would prefer to present only a small part of their currency holdings for conversion" (Sundaram & Pandit, Op.cit. p.147). It is not a matter of preference at all, but only of possibilities. All the amount which in various ways can be shown to be a part of the legally held cash balances, will be presented for conversion into legal tender. Our judgement about the forms in which black incomes and wealth exist and circulates in the

economy indicates that the proportion in the form of cash and particularly in the form of currency notes of 100 Rupees and Rs.50 denomination is going to be quite significant.[1] Despite the best possible manipulations resorted to by the black operators, the penal demonetisation move is likely to cancel and immobilise a rather sizeable part of black incomes and wealth. Moreover, loss of such liquid funds will tend to curtail a good many compound black income operations. Hence the impact on the economy will be through a sum which will be a multiple of the amount cancelled as a result of demonetisation.

Many limitations of demonetisation are pointed out from the point of view of its incapability to do away with the problem of black incomes altogether. Given the nature of the phenomenon, it is difficult to think of any single measure which can take care of the problem in its entirely, i.e., not only unearth and or nullify the entire volume of existing hoardes of black incomes, but prevent its further generation. Thus it is not particularly reasonable to apply such a high test of effectiveness to demonetisation. In any case, a considerable reduction in its volume and control over its proliferation is both a significant

objective and something likely to be sought and capable of being achieved.

Therefore, the limitation on demonetisation arising from non-monetary form of black incomes and wealth and conversion of cash into such non-monetary forms as a result of anticipation of demonetisation (see, Sundaram and Pandit, Ibid.) are insignificant and irrelevant. Since the majority of the suppliers of non-monetary assets are also indulging in black deals at the time of demonetisation some would be found to have moved into money and would be penalised *vis-a-vis* those who have moved into goods. In any case, demonetisation will reduce the demand for such assets and curb the generation of black incomes. The point, then, is to compare demonetisation with any alternative instrument available to a controlled private enterprise, market economy. On this criterion, there is hardly any other equally potent instrument which can knock out such a good deal of black wealth in one blow.

It has further been suggested that since presentation of black money for conversion attracts the attention

of income tax administration, knowcking out the stocks of black wealth also reduces important sources for generating the flow of black incomes. It is surprising to find that such an eminently sensible argument has been qualified by making presentation of black money of derecognised demonination for conversion an optional choice on account of letting their black character out! If demonetisation is not administered for undoing evaded taxes and incomes thus concealed, it has no other rationale! To the extent "the holders of black wealth are unlikely to come forward and present any significant part of their currency holdings for conversion" (Ibid, p.148), the policy of demonetisation is successful. And the greater the impounding of the stock, the greater is the curtailment of future flows emanating from those stocks.

It is not meant to choke the future flow of black incomes altogether, but only to curtail such flows, not only through eliminating considerable quantities of black wealth but also through the psychological deterrence it generates. In fact, being a penal measure, it reduces the actual realized rates of return. In this way it helps

a downword revision of of realizable rates of return and strikes a blow at the basis of black income generation.

Thus to argue that "in the measure to which demonetisation succeeds in eliminating the stock of black liquidity, it would fail in curbing the flow of black income" (Ibid, p.148) is either to misunderstand the relationship between black stocks and black flows or to posit uncalled for and over ambitions objectives for demonetisation, like curbing the future flow of black incomes altogether.

It may be suggested that since the basic forces and processes generating black incomes, are left untouched, will there not arise a need to go in for demonetisation again after a couple of years? Can such a drastic step be resorted to so often without seriously undermining public confidence in the currency? Given the basic framework of a controlled private enterprise economy, the phenomenon of black incomes and wealth is likely to assume over a period of time of say a decade or even earlier disturbing proportions even after a demonetisation has been attempted. A set of other measures designed to curtail the generation of black incomes, can slow down the process, and

thus delay the need for a subsequent round of demonetisation. In fact, a periodic reccurse to demonetisation will go a long-way, through its penal, deterrent effect, to bring about a downward adjustment in the acceptable rates of return from savings, enterprise and high-proficiency work. This would weaken the tendency towards tax-evasion and unaccounted activities.

The plea that such a policy perspective would weak public confidence in the currency is rather vague. To begin with, it admits, though indirectly the effectiveness of the measure to cancel illegally held currency. But what does one mean by weakening of cofidence in a currency? Would it mean that the store of value function of money would be discharged by means other than legal tender and people would minimise their cash-holdings, particularly in the form of high denomination currency notes? If so, what is the extent to which it is possible to find substitutes for money? To the extent, black incomes are not held in the form of money capital, the processes of extended reproduction of black wealth are weakened. It may be possible that fearing demonstration, people move

out of money at a very fast pace, pushing up the velocity of circulation. It is unlikely to carry this process beyond a point. But in generaly, in a modern highly specialised exchange economy, no general substitute for legal tender money is likely to be available. However, to the extent savings are not hoarded in the form of currency notes owing to the fear of demonetisation, they would have to be converted into other financial or physical assets. This would, in general, be a development to write home about. To think that the weakening of confidence in official currency may lead to the emergence of unofficial, informal currency on a reasonable widescale is to misread the nature of a modern economy. Thus the confidence argument can be made only so long as it is put in very vague forms. Its clear exposition exposes its weaknesses rather vividly. However, it must be admitted that the step of demonetisation would entail some administrative costs and hardships and inconvenience to honest tax payers and ordinary citizens. While one may plead for minimisation of the costs and inconvenience, there is little else which is possible under the circumstances.[2]

Thus for undoing the backlog of accumulated black incomes, demonetisation is a rather effective device.[3] Its

relatively lower political acceptability is an integral part of the problematic of the black economy and points to growing symbiotic relationship between the State and the lumpen capitalist classes. A choice against demonetisation and for schemes of voluntary disclosures and Special Bearer Bonds (Black Bonds) indicates increasing accomodation shown to holders of black wealth. Not only were the schemes of voluntary disclosures ineffective, but were also used for further creation of black incomes. The scheme of bearer bonds not only rewards dischonesty but by leaving a negotiable financial instrument in the hands of the black economy operations, provides an additional means for carrying on the black economy transactions. In so for as there are gains to be had from these bonds, the scheme tends to sustain the basic factor casuing black incomes, viz the hiatus between the acceptable (or desired) rate of returns and the post-tax rates of return. It marks a stage of a very high order of mutal accommodation and symbiosis between the State and business in India.

The foregoing arguments have not directed attention to the role of direct and routine administrative

actions like frequent and effectively organised investigations, surveys and searches to detect and penalise black incomes and wealth through seizures and imprisonment. Increasingly harsher measures, increased scale of the drive at detection and more severe social, economic and personal penalties will certainly go some distance in increasing the costs of tax evasion and black economy operations, A large number of suggestions and recommendations, made by many committees and experts on these issues are awaiting specific action aimed at implementation.

Notwithstanding the positive and desirable effects likely to arise from such steps, it may well be pointed out that such fire-fighting operations are subject to some clear-cut limitations. The values, motives and drives operative in the field of trade and industry which sustain the black economy cannot beyond a point leave the political and administrative spheres untouched. In fact, the greater the severity of the administrative-political drive against the black sector, the greater are likely to be the efforts at coopting the former into the mores and modus operandi of the black economy. Hence, the assumption that the administrative-political system can remain for long outside

the ambit of the black economy and can move against it as a target of attack may turn out to be unrealistic beyond a point. On the contrary, the two may evolve methods of mutual accommodation which may seriously constraint the effectiveness of the administrative legal steps detecting and inmobilising black incomes and wealth.

In so far as the black incomes and wealth circulate in the economy in the monetary form, sudden and swift demonetisation of currency notes of higher denominations in the most effective step aimed at imboilising them[4] May be one has to resort to demonetisation again because it cannot claim to do away with the phenomenon of the black economy lock, stock and barrel and for good. Such a prospect would be helpful in generating deterrence because not much escape from money is possible. However, it leaves the black incomes and wealth in non-monetary forms directly untouched. To these aspects we now turn.

NOTES

1. As Bhobatosh Datta "(Is demonatisation an effective Remedy for Black Money?" (Capital, January, 1978. pp.124-126) says," If demonetisation is to prove as an effective remedy for black money, Rs.100 notes should be demonetised. This is so, because, the share of this note in total note issue is very very significant (48 percent in May, 1977). This has been recommended in 1978 in the unpublished interim report of the Wanchoo Committee on Direct Taxes. p.125 (Emphasis added).

Noting a limitation of this measure, Prof. B. Datta wrote, "while it is possible that a good part of the clack cash is held in low denomination notes any attempt to demonetise Rs.100 notes will be less justified in 1978 than it would have been in 1970 (because in 1970 Rs.50 notes did not come into existence)" Ibid. p.125.

2. As Bhobatosh Datta puts it, "the actual conversion process associated with demonetisation will be inordinately complex, time-consuming and psychologically disturbing to the millions of persons who will be involved." (Ibid. p.125).

The issuance of Rs.20 notes has partly eased the problem of ensuring the supply of alternative currency. The problem may be further eased by opening temporary bank accounts with cheque books for people surrendering demonetised currency notes, especially in urban and semi-urban areas.

The fact that the smaller currency notes have greater velocity of circulation suggests that higher denomination notes are used more frequently for holding cash for longer periods.

3. It has been suggested that denomination can be partial (i.e., for a few, high denomination currency notes) or full (for the entire series of currency notes). See, Mohandas, M., Op.cit. p.14. To my mind, 'full' demonetisation is costly, unnecessary (because black incomes will still re-emerge), inconveneint and infeasible. One has not come across any advocacy of such a full demonetisation.

4. As Malcolm S. Adiseshiah (Op.cit. p.54) maintains, "Unaccounted money has now become so all pervasive and dominant in the economy, that the painful ultimate remedy of demonetisation should be seriously considered and supported by all political parties in the interest of their survival and all business houses engaged in legitimate business." (emphasis added).

VII

Dealing with Black Real Estate Effective Remedies

Real estate, especially in urban areas, but not leaving out the rural areas altogether, has come to be connected with the black economy in many different ways. It is a very important form in which accumulated black incomes are held. Such real estate provides ample opportunities for concealment. In this vast country, one may own land and buildings in many different States. Hence, it is difficult to apply a ceiling on the total number (or any other physical dimension) or on the total value of real estate property. It makes the evasion of wealth tax and estate duty easy. Then, landed property can be shown in the names of minors, dependents, non-working women, other relations, not to speak of outright fictitious names. The values of such properties can be easily manipulated to meet the exigencies, they can easily be under-stated or over-stated. Then, real estate provides further basis for using black incomes in lavish furnishing etc.

Over and above the ease with which investments can be made, concealed, under/overstated and kept out of the network of taxation, they also tend to give good financial returns. The financial returns comprise the rental income as well as capital gains through appreciation. Since high rentals are earned in the name of the fictitious owners, or are taken as a capitalised lump sum ("pugree"), they escape the tax net. Similarly, the practice of registration of buildings and lands at lower values, with the rest being received in undeclared cash, allows one to go in for transactions involving real estate without attracting heavy tax-liability. Such sales favour both the buyer and the seller - the former is allowed to use his black wealth while the latter escapes tax-liabilities. Thus, apart from the shortages-ridden land and housing market tending to push up real estate prices, the black-incomes-fed demand also contributes to the same result. The greater the rise in real estate prices, the greater is the attraction that black incomes and wealth would have for real estate. It is well-known that urban real estate prices have sky-rocketed in India over the last three decades. It is an index reflecting the growth of the black economy.

Methods of unearthing and penalising black wealth, it follows, must include methods which can produce one or more of the following results with respect to real estate:

1. detection of real estate held in fictitious names,
2. declaration of the correct sale price or cost of construction of houses, buildings and flats,
3. declaration of the actual rent received on real estate and prevention of 'pugree' payments in order to evade taxes.
4. discourage sinking of huge sums of black incomes and wealth in luxury housebuilding or buying in order to use past black wealth and evaded taxes,
5. prevention of speculation in land and buildings and the consequent big spurt in real estate prices.
6. reduction of the attractiveness of real estate as a form for holding stocks of black wealth so that such resources come into the open and are used according to social priorities.

Considering the wide sweep of the results sought to be achieved by interventions in the sector connected with real estate, particularly in view of its linkages

with the black economy, it will be difficult to conceive of any single measure which can yield the expected results. The Direct Taxes Enquiry Committee (Op.cit.) suggested the following measures in this connection:

a) compulsory acquisition of immovable properties in cases where either sale deeds do not reflect their fair market price or where the costs of construction are understated;

b) Amendment of the land Acquisition Act, 1894 to empower acquisition of immovable properties at prices stated in the last sale-deed if the property changed hands within a period of one year.

c) compulsory registration under the Indian Registration Act, 1908 of the Sale/Purchase of ownership flat whether through cooperatives or otherwise,

d) rent control should be restricted to residential premises only,

e) under the Stamp Act the purposes for which the paper is purchased must also be indicated as also the names of the parties to the transaction.

The first measure has already been implemented by the Taxation Laws (Amendment) Act, 1972. It gives the tax authorities the right to acquire properties exceeding the market value of Rs.25,000 and undersold by more than 15 per cent at their recorded prices plus 15 percent, though its has not been extended to the understatement of the cost of construction.

In view of the fact that despite nearly 30 thousand notices being given by October 1980 under the above stipulation, only 16 properties have in fact been compulsorily acquired, it appears that this provision is mainly in the form of a threat against under registration of value which has not actually been carried out to any reckonable extent. (Report, 1980-81), Ministry of Finance, GOI, pp.170-71).

Recently an ingenious suggestion has been made that the intentions behind the measure may be realised if the right to enter into transactions in immovable property is nationalised, without involving transfer of property to the State. (A Bhaduri, "Manace of Black Money: A feasible Remedy", Times of India, 12 August '81).

It means that the private property in real estate would be limited; anybody wishing to buy or sell real estate would have to do so through a public agency, which would either come to know the prices at which the deals are struck or are allowed or would have to play an important role in determining the prices. Such an involvement of a public agency would do away with the possibility of concealment or fictitious valuation and discourage speculative price spiral. The public agency, it appears, would be a kind of a broker and presumably, meet its costs by charging such a brokerage.

This scheme has been suggested as an alternative to nationalisation and ceiling on urban property. Not that these alternatives are not likely to be effective. The point is that they have been castigated as either "fundamentalist" or "first best solutions" (which blame everything on private property and hence fail to suggest anything non-utopion and presently feasible) or something for implementing which no democratically elected government in India has power or political determination, because it amount to destroying black money and the parallel economy which sustain it (Ibid).

To begin with, let us look at the operational modalities and inherent limitations of the suggestion. It is recognised that the potential buyers and sellers may informally arrive at a private deal before they register. their intentions to buy and sell and there may emerge a private, undeclared component to such "nationalised deals". The solution offered in terms of actual sale to those registered on a "first come, first served basis" implies that it is not in affect a sale but actually an administrative allocation.

Though the pricing processes, whether to be fixed by the public corporation, or arrived at by a competitive bidding, are not specified except ruling out a mutually agreed price between the buyer and the seller (the latter in effect, amounts to undoing nationalisation of transactions in real property), it is clear that it will have to be some sort of monopolistic pricing. Taking away from the private parties the right to dispose of or buy something entails taking away the right to arrive at a mutually agreed price between the potential buyers and sellers. In this situation, leaving out the question of the pricing principle and procedure adds an unwartanted

degree of vagueness to the proposal. To the extent, allocation is suggested, the terms of allocation are also, self-evidently, determined by the allocator. This makes the deal lose the character of a sale.

Is this much different from nationalisation? True, if one is not proposing to sell one's property, no State intervention is invited. But by taking over the right to sale and choice of buyers and implicitly, the term of sale, the right to own and hold property is also significantly eroded. The political pre-conditions for making such a move are not vastly differently from or much less fundamental than those involved in nationalisation. The feasibility of the proposed remedy on political grounds does not seem to be meaningfully different from that associated with ceilings etc. If the analogy of the canalisation of imports-through STC is given in support of the proposed nationalisation of deals in real estate, many acts of nationalisation, urban ceilings and land reforms can provide different kinds of analogues.

More important are the questions of administrative feasibility of the proposed move and its impact on the black economy. Maintaining such registers of proposed

sales and purchases, allocations and fixation of terms of sales leave ample scope for subjective discretion and corruption. Notification of the proposed sale in a certain area and of a certain type of property may acquire the form of an open bidding. Either it leads to high prices like the high prices of imported automobiles sold through the STC or if low and reasonable prices are fixed administratively, it creates a source of tremendous patronage, which is amenable to misuse in many ways and for diverse considerations. The dampening impact on speculative holding and sales and purchases are a function of prices and may survive through known and widespread malpractices like presenting a sale as a transfer of the right to use through power of attorney, which is widely used even now in the case of scarce, allocated goods like subsidised public housing and automobiles.

If the suggestion were successfully implemented, it will tend to discourage the future conversion of black wealth into real estate and future speculative dealings. However, it has no means of touching the past acquisitions of real estate and destroying such black wealth.

Since offer to sale invites loss of control and ownership and since future construction of such buildings is discouraged, the scarcity premium price on such real estate would increase. The hiatus between the actual and legally permissible rates of return would widen. Since much of the concentration of wealth will survive and continue to grow, the excess demand for real estate will continue and expand. All that will be needed then would be new forms in which such transactions are to be clinched, which sure enough the whole tribe of tax consultants and chartered accuntants will explore and devise. It will, in the last analysis, be yet another ineffective step, which has neither political nor administratively greater feasibility than the discarded alternatives nor any appreciable effectiveness in dealing with the menace of the black economy.

An alternative which can better meet the desired ends in so far as any single step of a policy-mix can, is to ensure that the right to compulsorily purchase properties at their understated purchase price or construction cost is effectively carried out. Presently such enabling powers have been incorporated in the tax

laws, without setting up adequate machinery for the task or allocating resources for the purpose. By October 1980, out of some 34 posts, 8 have been converted to those of IAC (Assessment) which are the competent authority under the Act for administering this provision (Report 1980-81, Ministry of Finance, Government of India, New Delhi). Not only that, but it is not clear what is to be done with such compulsorily bought real property and who will carry on the tasks. To expect that the tax administration can carry on such an onerous and extensive task is not only to widen the scope of tax administration somewhat arbitrarily but also to grossly overestimate its capabilities. In any case no estimate of the resulting additional administrative responsibilities seems to have been made, let alone the question of making any arrangements and provisions in this respect. Thus in the absence of any machinery, resources and modus operandi, the enactment of the enabling provision about compulsory purchase of under-valued properties is an empty threat and is known to everyone to be so. It has been used only in a handful of cases so far.

It is my contention that by taking the logical steps inherent in the already made decision to go in for mandatory purchase of undervalued properties, a great deal of dent can be made in the menace of the black wealth in so far as it has taken and takes the form of real estate.

Based on the assumption that the tax administration is neither meant to nor has the resources and expertise to go in for the task of assessing acquiring, operating and managing vast amounts of urban, semi-urban and rural real estate, it is suggested that let there be a public sector real estate corporation or a number of such corporations (one each for every tax administration zone) for operationalisation of the provisions concerning undertaking and present purchase of under valued properties.

The present law empowering compulsory purchase of undervalued properties is very cumbersome, slow and ineffective. Its underlying assumption about the scale of deliberate undervaluation and the extent of undervaluation in specific cases appear to be only a tiny fraction of the actual scale and extent. If appropriate urgency

is attached to the task of flushing out black savings out of this sector and removal of distortion in the real estate markets, a large scale acquisition of such properties in a few, time-bound, swift moves is an inescapable necessity. Given various estimates of the size of the black sector, the long period over which the phenomenon has been gathering strength and the role of real estate as a preferred form of holding black wealth, it would be simplistic, if one means business, to go on with the slow processes enunciated in the present law and make a dent on the problem. It is common knowledge how difficult it is to prove in a court of law that the declared value of a property is not its fair market value, particularly when almost every property is similarly under-registered. On the contrary, no tenent of a natural law is violated in mandatorily buying up suspected under-registered properties at a handsome margin of 15 percent within six months of its purchase or construction. In so far as the need of the buyer/to make use of this property for genuine purpose is concerned, the first option of hiring it may be given to him at the going market rent based on current market value of the property.

There can be some legal, technical and administrative problems in implementing this suggestion. A mandatory right to purchase such properties can be given, it may be maintained, under our law only to the government. If a statutory corporation cannot be given such an authority, the purchases, under the advice of and valuation by the proposed corporation, can be made by the Direct Tax administration. Even the finances can be provided by the proposed Corporation. Subsequently management and maintenance functions of such property may be vested in the proposed real Estate Corporations. The important things are: removal of the provision placing the onus of providing undervaluation on the basis of fair market price on public authorities and setting up of an independent, expert machinery to deal with this important and administratively feasible provision.

Just in order to provide some initial ideas in this connection, it may be suggested that the proposed corporations can be set up with joint financing by the central and state governments, public financial institutions, including banks. With an investment of a sizeable

sum, let us say, Rs.200/- crores, it can go about financing compulsory purchases by a competent authority of undervalued real estate, whether bought or freshly constructed on the basis of an assessment of their market prices made by its team of expert, professional valuers. These corporations will buy, sell and hire out the buildings and lands they control. They may also make these properties available, at a price, for public purposes.

Such corporations do not nationalise anything; they just buy properties at prices declared by their owners and thus penalise fraud and tax-evasion. These corporations will make profits by hiring out and resale. Thus no shortage will be created for any legitimate demand for land and buildings, provided a legal, full price is paid, disclosed and registered.

The scope of activities of these real estate corporations can be determined in one of the two ways. If past uses of black wealths are to be penalised and destroyed and an effective move against the black economy and its expansion is to be made, the corporations may be empowered to buy-up all the undervalued properties

(not necessarily at their historical cost or values declared at the time of their registration but even after adding a reasonable and proportionate escalation or at current values given in tax returns) registered over a period of, say, past ten years. But if the sights are set mainly on the present and future, then the coverage of the corporations may be confined to cover properties registered or built during the past two-three years or for the period for which tax assessments are to be made or are open for assessment.

Apart from killing black incomes and wealth invested in real estate, this move is bound to be deterrent and thus close or narrow down one important avenue for the use and reproduction of black incomes. To enhance its effectiveness, it may be essential to restrict the legal provisions concerning the right to transfer use by means of granting power of attorney. In general, this legal provision is defrauded for transfer of the usufruct in cases where sale/resale are legally prohibited.

Hence in such cases where sale/resale is to be restricted, it should be so defined as to include transfer of usage by means of power of attorney, irrespective

of the fact whether it is for a pecuniary or a non-pecuniary consideration; though the right to transfer responsibilities concerning the management of real estate in cases where the owner cannot for a certain period of time discharge them to genuine next of the kin or legal heirs may be permitted.

The impact of the operations of such a corporation on the black economy would be further strengthened by the sea-change this measure would surely bring about. As a result of the loss of attraction for these forms of holding black wealth by the black economy operators, the rise in the prices of land and buildings is likely to become moderate. The social consequences of such a move are, therefore, self-evidently desirable. If a ceiling on an all-India basis on the total value of urban estates is also enforced, it will add to the effectiveness of the measure. Thus the proposed scheme offers scope for variations over time and over different places; it is not a rigid scheme.

If demonetisation is resorted to destroy the black money circulating in the economy and, compulsory purchases of undervaludo real estate by a public corporation lead to loss of black properties, the total impact on the process of unearthing and destroying black incomes and wealth may be considerable. These measures will weaken the drive for further generation of black incomes. In sum, for the present these two basic steps can go as far as is politically and administr tively feasible in the prevailing set up.

VIII

A Miscellany of Measures

Since the banking system is also used on a fairly large scale by people with black savimgs for holding such wealth, it is essential to deal with this form of black wealth. A large number of undisclosed accounts are maintained in different branches and different banks by people with black wealth. Similarly, undisclosed fixed deposits are also made in very many different names. Apart from earning handsome interest, it is safe and easy to hold the fixed deposit receipts. The funds with the banks also possess a good degree of liquidity.

Apart from making repayment on maturity by crossed cheques compulsory, presently seizures and searches are the only means used for unearthing this kind of concealed wealth. It appears that vigorous effort are necessary to make banking accounts accessible and consistent with tax returns. Computerisation of information regarding banks accounts and availability of these data to the tax authorities, (who should cross verify themagainst computerised composite tax returns) may make concealment of dealings with banks difficult.

Yet another innovative step for making concealment of dealings with banks difficult is to supplement permanent income tax account numbers with Central Taxes Pass-Books. These pass books can carry the summary details of one's assessed income and wealth levels, sources of income, major items of wealth, entries about gifts made or received, bank accounts with periodic closing balances, fixed deposits with maturity dates, etc. Such pass books can be made a compulsory document for registration of a business firm. Apart from tax authorities and banks making entries in the Pass Book all other major deals like major investments in real estate, plants and machinery, purchase of shares, debentures, etc. borrowing and lending etc. (according to levels specified for different income groups) must also be recorded in it. All bank accounts with average balances accounting to a stipulated sum, say Rs.5,000 or Rs.10,000, must also be opened on the basis of presentation of such pass books and must be entered into it.

Whatever benami or fictitious deals escape such a Pass Book, may be detected through the regional and central computerisation of bank accounts above a specified level of average balances and their cross-checking against computerised tax returns.

A number of studied recommendations made by the Direct Taxes Enquiry Committee are still awaiting implementation. (For details, see Chapter 2 and 3 of the Report. See a summary on pp.167-182). For example, combined tax returns for income, wealth, gift and estate duty will help prover assessment and cross checking for authenticity. In the context of a Pass Books on Taxes, such a combined return becomes all the more useful.

Among the important measures suggested by the ommittee, mention may be made of the following:

i) Public financing of political parties and legitimate election expenses alongwith provision of proper maintenance of accounts and their statutory audit. Ceilings on individual, tax-deductible donations to political parties.

ii) Control over entertainment expenditure by businessmen according to the criterion of furtherance of business and inclusion of guest houses in this category.

iii) Changes in provisions relating to penalty.

iv) A number of suggestions concerning prosecutions of tax offenders.

v) Strengthening of tax intelligence and investigation machinery.

vi) Uniform tax on agricultural incomes on par with other incomes by the Central Government;

vii) Greater co-ordination between income-tax and sales tax authorities;

viii) Compulsory maintenance of accounts at specified levels of income and longer preservation of account books like ledgers and cash books;

ix) Compulsory audit of accounts and specification of some important items on which the auditors should make a report.

x) Power of survey and increased scope for survey by income tax authorities.

xi) Steps for collection, collation and dissemination of information;

xii) Better, sustained and systematic coordination between banks and income tax department;

xiii) Reintroduction of expenditure tax;

xiv) Uniform accounting year;

xv) Tax treaties with foreign countries for exchange of information relating to tax-evasion;

xvi) Special measures for checking tax evasion in film and construction industry.

xvii) Payment above a specified level by crossed cheques or crossed bank drafts;

xviii) Regulation of Hundi loans;

xix) Amendments concerning blank transfer of shares;

xx) Denial of Credit facilities to tax evaders.

A large number of steps have also been suggested for dealing with tax avoidance (DTEC, Chapter 3) Action is still pending on most of the measures. A number of these measures require further study, modifications and strengthening in order to produce desired results. However, they will initiate a clear-cut process of an offensive against existing black wealth as well as the processes of its continued generation.

However, these measures need to be supplemented by many additional steps. In the following we discuss some measures which we consider important, without of course, claiming to construct a complete package.

The corporate sector is an important form of economic activities representing a heightened form of socialisation of the process of production, more particularly with respect to productive forces than with respect to social production relations. It is at its weakest in bringing about the socialisation of the ownership of the means of production. A number of devices for social control and regulation of the corporate form of economic activities in their organisational-managerial

aspects are a universal feature of the legal system in every capitalist economy. The corpus of company law, capital issue control, laws regulating stock exchanges and share markets, etc. are a part of the legal system in every market economy.

These forms of public control over the social resources organised under a corporate entity are inadequate to ensure that they are not used for private gain of the promoters, board of directors and actual managers to the deteriment of the interests of the shareholders and the general public, in violation of the laws permitting and prescribing the modalities of the company form of organisation. Auditing of the accounts by independent and importial agencies is an important means to exercise control over corporate operations. In India, the companies are statutorily required to get their accounts audited. Beginning with the Income-tax Investigations Commission, all the subsequent expert committees and commissions (like The Direct Taxes Administration Enquiry Committee, Administrative Reforms Commission's Working Group and the Direct Taxes Enquiry Committee) have recommended that compulsory audit must be extended to cover non-corporate

business and large income earners. The Direct Taxes Enquiry Committee wanted auditing to be made mandatory "in all cases of business or profession where the sales/turnover/receipts exceed Rs.5 lakhs or the profit before tax exceed Rs.50,000" (p.47). They further recommended that "a form of audit report be prescribed taking due note of the manner in which documents, records, and books are maintained in the non-corporate sector." (p.47).

While agreeing with the general proposition that submission of audited accounts will save the tax authorities from the tedious and time-consuming processes of scrutiny of accounts from many not so directly tax-related angles and will introduce greater systematisation and uniformity in the accounts of the non-corporate business, one is unable to see much appreciable reduction in the scope for tax avoidance/evasion simply by insisting on compulsory audit. If a post-mortem examination by the auditors could ensure such things as elimination of black incomes, the corporate sector should have been rid of this scourge long back !

It is not difficult to see why compulsory auditing by professional chartered accountants can go only a short distance in checking the generation of black incomes and ensuring the maintenance of larger social or narrower share-holder interests in corporate activities.

To begin with, auditing is largely a formal scrutiny and does not generally go into substantive questions like the need and rationale of a particular item of expenditure which is claimed to be legitimate business expenditure (and hence is tax-deductible) or the rationale of a particular sale or purchase price in any transaction. Thus, by and large, such audit can neither ask questions about the rationale for entering into certain transactions nor about the terms on which the transactions are carried out. Hence its ability to stop or restrain manipulation with a view to avoid or evode taxes is considerably limited.

There are other possible reasons why audit may be of limited effectiveness in curbing manipulation of accounts with a view to evade taxes. The chartered accounts are chosen by the firms seeking audit and the mutually agreed remuneration is paid by the firms. The

chartered accountants are privately practicing professionals, who, like any other businessman operating on one's own account, want to maximise their returns. The earnings of the C.A.'s, is a function not only of the rate of remuneration but, also of the number of audit assignments they are able to bag. While there are no rewards available if they do a thorough scrutiny, exposing manipulation of accounts, they may easily lose the contract in favour of a more pliable firm of accountants for this very reason. Then, the accountants undertake not only audit functions, but (statedly or otherwise) they also perform advisory functions on how to maintain and present accounts and do various other things in order to avoid or evade taxes and maximise net, post-tax earnings. In any case, the C.A. firms may themselves have a need to evade taxes and conceal earnings like any other business. Thus, there are enough _a priori_ grounds to expect the auditors to be in league with the tax evaders.

A number of raids recently conducted on the firms of C.A.'s gave evidence that many auditors are a party to the games of black economy operations. The tendency to have a high degree of concentration of audit assignments

in the hands of a small number of concerns (See DTEC, Final Report, p.46) improve the prospects of such collusive behaviour. The increasing popularity and prosperity of taxation consultants and ever new ingenious ways of beating the tax laws they devise lend credence to the suspicion that auditing and taxation evasion and avoidance advice may, statedly or unstatedly, go hand in hand.

Thus it is clear that the auditing profession, structured as it is, will not be in a position to contribute significantly to prevention of tax evasion when audit is made mandatory for the non-corporate business. Much depends on who does the auditing, how, on what considerations and for what ends. There is no reason to attach any great significance to audit as such as a magic wand.

However, in refering to the collusion developing between the auditors and business firms, nothing concerning the integrity and other related aspects of the professionals in audit is implied which may not apply to other professions and businesses in an equal or even greater measure. The point simply is that given the nature of business and the basic factors making for the genesis of the black

incomes, auditing of the kind prevalent and the manner in which it is organised, cannot be expected to restrain black incomes. On the countrary, it may add to it with legitimation attached as a super bonus.

Given the nature of the highly sensitive operation which the auditors are called upon to perform if audit is to be used not as a mere verification of the accounts in a formal sense but as an instrument to detect concealment and manipulation and prescribe forms for maintaining and scrutiny of accounts, it is clear that the conventional concept of audit and its prevalent private practice are no means to attain these social ends. In the changed role, audit becomes a means of social accountability of private business to the extent such accountability can be ensured through expert scrutiny of private activities. It is self-evident that such social accountability role cannot be enforced by audit itself organised as a private enterprise. Thus both a different concept of audit and its nationalisation are an essential precondition for the success of the attempts at expost content scrutiny of accounts from the point of view of ensuring social accountability of private business including reduction in the scope for tax

evasion through window-dressing of accounts.

Introduction of such a concept and mechanism of audit are new and as yet unexplored steps about which a good deal of creative experimentation alone can ensure results (spread necessarily over a somewhat longish period) which are in keeping with the expectations.

Improvements in tax laws and their administration can also make some contribution towards reducing black incomes and their proliferation.

Various tax laws contain provisions for prosecution of the tax offenders. Examination of the statistics in this regard reveals that very few prosecutions have been launched after searches and seizures. Presently, it is the practice that prosecutions are launched after obtaining the approval of the government, which means that of the Minister concerned. It is suggested that whenever launching of prosecutions are not approved by the Minister, the reasons for the same should be laid before the Parliament, giving, inter-alia, the particulars of the tax offenders and the magnitude of the tax evasion involved.

There is no reason to give such decisions the protection of secrecy.

The direct taxes laws (income Tax Act and Wealth Tax Act in particular) contain provisions requiring the Central Government to publish the names and other particulars of the tax offenders involved in prosecutions by the law enforcement agencies. These provisions were introduced over five years ago, but we do not yet see any names of the tax offenders published for the information of the public.

Various tax laws contain provisions enabling the enforcement agencies to authorise searches where they have reasons to believe that any incriminating material leading to the unearthing of evidence of tax evasion would be found. These provisions contain enough safeguards to protect the interests of the law abiding citizens and to ensure that they are not harassed. Remedies can also be provided to the citizens against harassment. The system of informal consultation with the political leadership concerning ordering of searches and seizures, that is reported to be prevalent in some taxation

department, does not have the sanction of the law as passed by the Parliament. The Ministers should be allowed only to order such searches but should not be allowed to prevent any searches. A periodic review and public statement of the reasons for unsuccessful searches can also be helpful in strengthening this measure.

It is common knowledge that income on which tax is evaded is use to a large extent for luxury expenditure. Some years ago, a provision was made in the income tax Rule (Rule 12) requiring the income tax payers to indicate, in the Returns of their income, all those items of expenditure on which an outlay exceeding Rs.2500/- was incurred. The purpose of the move was to build an information system whereby the correctness of the income shown could be verified through cross-checking with expenditure, particularly in view of the durable luxury goods on which black incomes are lavishly spent. Even Return Forms containing a separate part for disclosing these particulars was prepared. Unfortunately, soon after this provision was made and forms for the purpose prepared, before it could be tried even for one year, its operation was suspended and after some years, it has now been completed given up. One learns that some

Chambers of Commerce actively lobbied and represented against this measure.

These measures are likely to improve the anti tax-evasion potential of the tax administration. Some of the measures will weaken the channels for interference by the politicians, build up public disapprobation against tax evaders and make the task of income concealment a little more difficult. These steps will also contribute to building up of the morale of the actual, man-on-the-spot to go ahead with his bounded duties without much risk of being fettered by illegitimate political interference.

IX

Long-Term Perspective

Issues for Current Mobilization

We have discussed in Chapter Four how there are "certain sharply identifiable limits on various efforts meant to curb" the black sector. It was argued that "the objective of elimination of the black sector is not likely to be set up or accepted by public policy." It was shown that certain categories of black incomes which arise in association with legal activities and transactions and political-administrative black "incomes" can be reduced only to a certain limited extent. This was because these black incomes can be curtailed only to the extent there are basic changes in the political and constitutional structure (like electoral reforms, formalisation of the role of business and industry in politics, development of centres of countervailing power to the power of money, like enhanced role of agricultural and industrial labour.

Such changes in the political system will have to be based on a programme of important changes in the economic sphere. This is because so long as the locus of economic policies does not cover policies of relatively more fundamental type which do not hesitate to infringe the right to private property and enterprise, there will be a certain inevitable degree of expansion of the black sector when economic expansion in the private sector is brought about through public policy interventions in a planned manner. We have discussed in chapter four how the rate of growth of private sector and black incomes are highly and systematically correlated. It was argued that clamping down on the black sector may disturb the actual conduits and mechanisms for expansion of private economic activities. It was concluded that "the rigid, ideological (as opposed to functional criteria of economic capability and historical feasibility) conception of what has come to be called the Indian mixed economy limits the possibilities of doing away with the black sector."

The argument, in a nutshell, for the above view was that "curtailing black incomes slows down "growth", weakens incentives for expansion of private investment on account

of lower rates of permissible, post-tax returns, closes some sources for funds and inputs needed for expansion, reduces the consumption of many luxuries which provide a spur to private efforts and initiative." If these processes are restrained, there emerge in the system pressures to look for non-private sector agencies for growth. Given the present day commitment to the role and scope of the private sector, such pressures come into conflict with preferred policy paramenters.

There is another obvious dimension to the prospects for curbing the black economy. A policy framework which has relied upon the expansion of the private sector as a means for many of its macro-level, socio-economic objectives, discovers that curbing the black sector is not feasible beyond a point without curbing the growth of the private sector. But it is not a question of techno-economic feasibility alone. The private sector acquires in this process a certain additional socio-political power and dominance in order to discard as undesirable the processes and policies like those curbing the black sector which are inimical to its interests. Thus, expansion and strengthening of private enterprise no longer remains a mere <u>means</u>, it tends to acquire the character of an <u>end</u> also.

The question then becomes how to redefine the relative roles of public and private sectors with a view to weaken the correlation between general economic expansion which occurs of necessity mainly in the private sector and the expansion of the black sector. To begin with, let it be clarified that it is not implied that the expansion of the public sector amounts ipso facto to a reduction in the scope for generation of black incomes. Our analysis of the nature of the black economy delineated a category of black incomes called "political-administrative black incomes." particularly in the context of a mixed, private enterprise economy, ridden with structural shortages and slow growth of income-earning opportunities. The linkages of the public and the private sector necessitate a large number of inter-sectoral transactions. The determination of the terms of such transactions leaves considerable scope for creation of political - administrative black incomes. It is no place to elaborate the mechanisms, motives and opportunities for the creation of a black counterpart to public sector operations.

What still must be emphasised is that compared to the expansion of the black sector associated with the expansion of the private sector, there is considerably lesser scope for the expansion of the black sector in association with the growth of the public sector. To begin with, there is hardly any scope and motivation for the creation of simple black incomes. Normally it is the simple black incomes which are the main sustenance of compound black incomes. To the extent, there are administrative-political black "incomes" in the hands of the managers and decision-makers in the public sector, there may be some limited generation of compound black incomes. However, the basic motivation arising from the divergence between acceptable and post-tax actual returns does not apply to public sector functioning (as distinct from individuals associated with it). Thus the phenomenon of substantial and sustained generation of black incomes can apply to it only tangentially.

A redefinition of the role of the public and private sectors on the basis of an explicit, ranked set of criteria, including one concerning the motivation, possibilities and

scope for generation and extended reproduction of black incomes, has become an urgent necessity at the present stage of Indian development. A bigger role for the public sector reduces the correlation between the growth of the economy and the growth of black incomes because this may lead to a decline in the relative size of private sector whose quest for higher than legally permissible rates of returns is the bedrock on which the black economy rests.

How to increase the role of the public sector and in which areas? This question cannot be answered exclusively in terms of the objective of reducing the scope for generation of black incomes. A large number of other considerations too enter, though, fortunately, they all seem to work in the same direction.

The public sector in India has grown in terms of the considerations arising from the strategy of development enunciated in the five year plans, the structural gaps in the economy, the industrial policy resolution and the pressures of various kinds arising in the political sphere, most importantly the lobbying and pressures from big capital and international financial agencies. As the

initial weaknesses of resources, expertise, managerial abilities, domestic availabilities of many inputs and resources, inadequacy of demand, ways of dealing with the government, politicians and public, inadequately diversified economy, helplessness vis-a-vis international capital etc. were substantially overcome by about late sixties, the stance of the private sector with respect to the role of the public sector began to change. This change is also related to the attitude of the organised and large sized private sector towards foreign capital, particularly foreign private capital, technology and enterprise. Foreign private capital or the western capitalist countries never looked kindly to the policies of expansion of public sector in India. But Indian capital, while apprehensive of the access given to foreign capital in India, was generally favourably inclined to fresh public investment based public sector (as against take-over based public sector or public sector based on denial of the right to private enterprise to operate in certain reserved areas in terms of the Industrial Policy Resolution, 1956). But having grown under the umbrella of protection, under the impetus of growing public investment and public sector and through collaborations based import-substitution, the Indian big business came to see more of a threat from public sector than from foreign capital, enterprise and technology.

As a result of the new accomodation and understanding between Indian big business and international capital, they made a sort of common cause against the public sector, particularly against its expansion, diversification and strengthening. Such limits on public sector were expected to lead to increased scope for the expansion and strengthening of big private capital as well as international capital in the form of MNCs.

The power of black money and its enlarged penetration in the political sphere, coupled with difficulties in raising resources for financing the growth of public sector, particularly in the field of heavy and basic capital goods industries led to a slow-down in the growth of public sector. The efficacy of economic controls and regulation became limited because the State could not muster strength to bring about, over a longer period, changes in output, product mix, employment, location of economic activities, technology, etc., which were essential to supplement the policy aims sought to be achieved through short-run economic regulations and controls. Various kinds of shortages and distortions, actual or anticipated, impel the

Government to institute various price, output, investment, location, capital issue, credit, fiscal and a good many physical controls. These controls delimit, prohibit, modify or redirect private decision-making in various ways.

For example, shortages of critical commodities and the consequent rise in market prices make the government impose price and distribution controls. Irrespective of whether the controls are successful and lead to controlled distribution and limited returns to producers/or whether the controls are bypassed leading to black marketing and illegal high returns, the impact on fresh investment in order to meet the shortages is unlikely to be highly encouraging and capable of wiping out the shortages. While the success of such controls will lead to diversion of investments to other uncontrolled spheres, the failure of the controls will lead to the development of vested interests in perpetuating shortages. Thus licences for expansion and setting up of new units will be pre-empted but will not be acted upon. Existing capacities will not be utilised. The fact of controls will tend to fetter whatever incentives may be offered for expansion.

Thus the only effective way to deal with short-run controls is to make a big public entry in the area of shortages and go in for a realistic price policy designed to ensure good returns for the expanded public sector output. Thus one important area in which fresh entry and expansion of public sector is required is in the area of endemic shortages which cannot be met by imposing controls over and providing incentives to private sector. In other words, controls initiated in order to meet shortages need to be supplemented by adequate public investment in order to meet the shortage and eliminate the need for the continuation of controls. In so far as the market mechanism may lead to shortages which cannot be expected to be automatically corrected, short-run public controls will have to be supplemented by direct public entry in to these fields, whether it be by fresh investment or by take-overs.

It is obvious that such controls need to be imposed on such commodities alone which have a high social priority. In the case of non-essential goods, the market response to shortages need not be interfered with and market correctives may be relied upon to meet the shortages.

This brings one to an important area for further expansion of public sector, which meets the test of many criteria, not just that of delimiting the scope and motive for generation of black incomes. In the scheme of allocation of spheres between the public and the private sectors in terms of the Industrial Policy Resolution 1956, the entire range of mass-consumption, wage-goods was alloted to the private sector. The allocation was almost exclusive in as much as the areas reserved for the public sector did not include any industry producing mass consumption goods. Additionally no policy of take-over of essential mass consumption goods industries was formulated. Thus only the residuary right of the State to enter any field deemed essential in public interest could have been invoked to allow it to enter these industries; something which did not actually happen to any marked extent.

However, priority to the production of mass consumption goods on a growing scale is a precondition for fighting inflation, enlarged employment generation and redistribution of income in an egalitarian manner. A big and growing role for the private sector works in many different ways against increasing the proprotion of mass consumption goods in industrial consumer goods.

Apart from increasing the incomes going to profit, dividends and interest earners, the technological, product-mix and indigenous-imported inputs components choices made by the private sector also tend to bring about greater concentration of incomes and assets. The pull of demand caused by such income distribution works against mass consumption goods. Moreover, since the mass consumption goods industries are generally conventional industries with relatively low profitability, not only new investments tend to go to modern, high profitability industries but even maintenance, replacement and modernisation in the conventional industries are neglected leading to the emergence of widespread industrial sickenss. The growth of black incomes associated with the growth of private sector also favours production of inessentials and luxuries.

It follows from the above that a high priority to the production of mass consumption goods is not possible without enlarged entry of the public sector in this field. Since existing highly skewed distribution of income puts severe limits on the size of the domestic market for mass consumption goods, not much private investment is forth-coming for these goods. In a way, it is the prkor

production of mass consumption goods with labour absorbing technologies based on indigenous resource-endowment (these conditions themselves show the need for public sector) which will provide the market for these goods. Thus public investment in mass consumption goods will become viable and self-sustaining alongwith making a contribution to the process of development in the real sense of the term.

A big spurt in the growth of mass consumption goods industries in India at the present stage of her development, brought about through increased role of the public sector in the process, contributes to many other imperatives. It will generate a good deal of demand for the basic and capital goods industries of India's public sector which are presently handicapped by unutilised capacity owing to inadequate demand. A fillip given to the basic, capital goods segment of the Indian public sector is likely to improve the level of surpluses generated in these industries.

The competition provided by the public sector mass consumption goods industries may slow down the spread of

industrial sickness. The role of the public sector in this area will impart it effective structural strength leading to its acquisition of effective countervailing role *vis-a-vis* monopolies.

In so far as this limitation on the role of the private sector in the field of mass consumption goods industries is concerned, it will have to be strengthened by curbing the role of private trade in these commodities. Presently the public distribution system has some important limitations. First, it is largely concerned with food products. Then, it is a supplement to the role of private distributive trade and does not curtail its role through exclusion from certain sphres. Last but not the least, the public distribution system is largely an urban affair.

There are many pressing reasons for a more effective and widespread public distribution system covering the essential mass consumption goods. One may add another reason for this arising in connection with the policies for curbing the black sector. Merchant capital operates in the black economy on a sizeable scale. The shortages which arise in certain important commodities are accentuated and taken undue advantage of by the merchant

capital. Even in the case of public sector administered prices, where prices are allowed to respond but slowly and inadequately to changing market situation, the merchant capital makes huge gains in the form of compound black incomes. As far as possible there should be vertical integration of the wholesale distribution of the products of public enterprises. The surpluses which the market yields with respect to public sector products, either directly or by use as inputs, must not be allowed to pass into private hands, much less their, monopolisation. Thus, extension of the public sector in the form of public distribution system and state trading in important commodities is an effective step for curbing the scope for generation of black incomes and investment of black sector savings. For preventing leakages of foreign exchange through under and over-invoicing, the role of the State trading corporations should be expanded to cover the bulk of this foreign trade, including purchase of technology. These steps meet many additional policy aims.

It follows from the above that a redifinition of the concept of mixed economy so as to allow extensive entry to the public sector in the production and distribution of mass consumption goods, serves, <u>inter alia,</u>

the purpose of restricting the scope and potential for the generation of black incomes. The essential logic of the policy of a dynamic concept of public sector, with its growing role in critical areas of production and distribution, is that there are inherent limits to the capacity of Smithian "prudence" of the private enterprise to produce outcomes confirming to Smithian social "beneficence".

The controls and regulation of private activities cannot go very far for a variety of reasons. Not only that, by itself, but there is also a distinct possibility that, under some specific conditions, a system of economic controls might produce a series of inter-connected distortions in the economic and political spheres. As a result the controls may lead to results contrary to those for which they are initiated.

The basic reason for the occurrence of such a phenomenon is the continued and growing control over economic processes exercised by the private sector (often with the support of State policies) and the non-availability of power, resources and facilities to

the public authorities to intervene directly in the economy except through the agency of the private sector. Thus, on the one hand, the political processes cannot be assumed to operate in isolation from the power and pull of the growing private sector. The extent, methods and content of the controls are, therefore, not independent of the interests of and acceptability to the private sector. Even after the introduction of controls for some specific objectives, their implementation processes are influenced by the power inherent in the private control over productive processes.

The absence of countervailing power in public hands which can give it a capacity independent of the private sector to produce desired results restricts its capacity to make the controls effective. A private sector constrained from doing certain things or from doing them in a manner or on terms to their liking can retaliate in a number of ways, including no-action (a sort of strike) or hidden action (black sector operations).

For example, high rates of taxation, which, in effect reduce the degree of privateness of private property, irk the private sector, at times, even to the extent of producing what Musgrave calls "spite effect by with holding supplies. (Public Finance, The Theory of, New York, 1959, p.240). But a government which does not permit itself to enter the activity of directly undertaking the responsibility of producing those goods whose supplies are either persistently reduced or inadequately increased by the private sector, cannot meet the challenge.

Such an outcome is often mistakenly blamed on the extreme nature of the controls and regulations, like high tax rates. This, however, is a mistaken and partial view. It is the combination of such policies curbing private property and enterprise with the policies of undiminished reliance on the private sector to produce goods and services on terms imposed by a government which lacks an independent capacity of its own to meet the bill and is subject to political processes under the influence of the propertied sections, which lead to a mixure of distorted and ineffective controls. What is thus under challenge are the

supposedly politically neutral capacities of the governments to enforce controls infringing property rights in an institutional context which gives the government little direct control over the production, distribution and investment processes. Therefore the size, composition and nature of the public sector must of necessity be in confirmity, among other considerations, with the severity and extent of control which the public system intends to impose on the private sector. Hence an independent economic base provided by a flexible and dynamic concept of public sector is essential in order to provide the necessary economic strength for carrying out economic controls and regulation.

The political preconditions for the acceptance of such a policy with respect to the public sector, which is under attack both by domestic and international capital are hardly in evidence. Hence presently the perspective concerning role of public sector is an issue for mobilisation and campaign, which may also form a part of the campaigns launched against the black phenomenon.

X

Summary and Conclusions

The phenomenon of the black economy has received scant attention of social scientists in a serious and systematic manner. As the black economy phenomenon grows in its volume, intensity seriousness (or, should one say, ferociousness) and coverage of different walks of life, the increasing frequency of references to it is matched by diminishing understanding of its real character and increasing degree of helplessness towards its growing power.

There are, broadly, three types of responses to the black economy. Either one sees moralising sermons bemoaning depreciation of the national character. Or, one comes across a wholesale condemnation of public regulations and controls for forcing business, industry and professionals to resort to black deals. These views altogether forget the implications of an uncontrolled, market mechanism economy as well as the faulty, inconsistent and faltering conception and design of the controls. Then, based on a technocratic obsession, there are a large number of attempts

at quantification of its volume, with little, if any, understanding of the nature, types, uses and sources of black incomes and the resulting black economy.

Why is it that while such responses to the phenomenon of the black economy predominate, an integrated social science approach to it as an objective phenomenon vitally connected with the political economy of the country is rarely evidenced? This is a question which can take up into questions and issues different from those which are being attempted to be analysed in the present exercise. But a survey of the literature (see Bibliography) leaves one in little doubt that the problem of black incomes and economy is at a very embroynic state of study and analysis.

In the present exercise in the First Chapter, an attempt is made to analyse the character of the black economy and evolve an adequate and appropriate conceptual framework for the study of its types, sources, forms and uses. Obviously, without positing a set of hypotheses concerning the origin of 'black' or 'unaccounted', incomes, it would not be possible to distinguish between various

categories or types of black incomes and the mechanism through which the black incomes operate in the system and relate themselves to variour variables and processes in the economy and polity.

Looking at the economy in terms of its real, circulation and control spheres, it is shown how black incomes and its uses operate in each of the spheres. Basically arising in the process of the ongoing interaction between the real and control spheres, black incomes owe their genesis to a sharp and sizeable hiatus between the feasible and acceptable rates of return (related to the real and circulation spheres) and the post-tax, permissible rates of return (related to the control sphere). Given the inherent nature of private enterprise to accomplish all that is feasible and rewarding and the nature of the polity which willingly responds to the basic tax sources of social and economic power, one sees not only the emergence of black incomes but through processes of holding and using them in various ways, (giving security, good returns and power), the emergence of a black sector or black economy, which is popularly though somewhat inappropriately

called the parallel economy.

A deductive analysis leads to a threefold classification of black incomes: Simple (arising from tax evasion), compound (not only tax evasion, but inherenthy illegal activity or legal activity based on unaccounted income and wealth, rendering it undeclarable) and political administrative black incomes; of these the last may be only a fraction of the first two but essential if these two are allowed to be created, held, used and multiplied. Though at a point of time, the black economy will have both a certain kind of flows and a certain types of stocks, but the operational mechanics of the black economy ties the stocks and flows into many complex, feedback relationships. Moreover, the two sub-groups of compound black incomes, (viz, the illegal and hidden, and the illegal and hidden component of the legal), forge important hot links between the legal and the black economies, turning a vast segment of the economy effectively into a 'grey' sector.

That apart from currency notes, there are very many different uses and forms of holding black incomes (giving a

range of choices based on a trade-off between security and yields) and these asset forms keep changing, make a total indentification of black incomes with black money a highly restricted possibility.

The inherent fungibility of money and credit also make 'black money' an operationally inappropriate category, With varying degrees of risks, difficulties and manipulation, savings out of black incomes(after satisfying all the extravagant needs of luxury conspicuous consumption) are used practically in all the possible forms which legal and accoumted savings take. Thus there develop costant links, supported by the logic of structural input-output relations between the black and the white economies. This is how in the black economy one finds a mechanism which frustrates and reverses all social and governmental controls, making the system approximate, in a distorted form, an uncontrolled, market economy.

The dynamics of the black economy, based on transactions financed by black incomes and dealings in black assets and black sector good and services, makes the size of the black economy a multiple of the amounts of black incomes and

black money existing at a point of time (the stock). This is a factor helped by the relatively greater velocity of circulation of black incomes and relatively faster turn-over of black deals.

Apart from the limited practical utility of knowing the size of the black economy (with due apologies to the followers of the scientific pursuit of quantification), the close affinity between the task of estimation (a forte of a certain school of economists) and detection (the task of tax administration) tend to dim the prospects of arriving at a meaningful estimate of the size of the black economy, with its vast 'grey' component! In any case, such exercises tend to bring about a misallocation of resources away from the analysis of various channels, and mechanism for the creation, use and extended reprodction of black incomes. The latter exercise enables one to know the effects, produced by the black economy as well as devise policy-designs capable of controlling and eliminating various forms, uses and channels of the operation of the black economy, However, indirect evidence about the mechanism of the black economy may become available by cross-checking the internal consistency of some published

and available macro-economic data.

The study of the black economy is made difficult on account of the formal models of the capitalist economy which abstract from force, fraud and informal arrangements, playing systematic roles under late capitalism. Afterall, the phenomenon of the black economy is an evidence of lumpenisation of capitalism as it moves, in India, from monopoly capitalism (evolved during 1950-1975 to state monopoly capitalism after approximately 1975). This process is inherent in the system, particularly in post-colonial, enclave growth societies in which weak capitalism was sought to be developed through state-sponsored planning and public investment with the hope that the former will remain subservient to and amenable to control by the latter. It was not realised that the growth of private economic, industrial and financial power was bound to become a means for further concentration of such powers in the hands of newly emergent dominant groups reducing the autonomy of the state apparatns. This process was further facilitated by the fact that there was a virtual demobilisation of the popular forces, except on electoral or sectarian issues.

such an operational model of the political economy of India can provide clues about the consequences produced by the black economy. True, a comprehensive model of the economy incorporating the black economy(based on non-conventional, secret devices, going as far as human 'ingenuity' can go), essential for a full exposition of the effects generated by the black economy, cannot be prepared. However we provide a partial picture of the effects produced by the operations of the black economy, which also at the same time indicate various devices and channels used by the black operators: **Certainly a useful input for policy formulation.**

Simple black incomes, apart from causing loss of public revenue and distorting fiscal policy, strike a blow against the use of taxation as a means for reducing post-tax inequalities of incomes. Growth of black incomes distorts consumption and production patterns in favour of luxury, wasteful consumption, reduction in household, corporate and public savings and misdirection of investment from mass comsuption goods capacities to wasteful, conspicuous. consumption capacities. These processes lead to adverse consequences for employment expansion, reduction of imports

of unecessary equipments, plants, technologies and capital and worsening output-capital ratio. The inflationary effects arising from imitative, externally-oriented, capital-intensive industral growth are further strengthened by speculative stock piling, financed out of black savings. The inordinate demand for gold, silver, precious stones, jewellery and real estate, apart from being anti-development, produce inflationary consequences. The leakage of foreign exchange in the form of compound black incomes through under and over-invoicing leads to loss of valuable foreign exchange. These leakages are further helped by technical and financial collaborations based on high fees and royalties shared clandestinely to generate illegal externally-held wealth. Such illegally-held foreign exchange amounts to a forced, interest free loan from India to the wealthier countries.

The forays made by the black sector into real estate tends the push up the prices of lands and buildings, strengthen speculation and worsen the housing problem for the urban poor and other fixed income groups. It helps perversion of housing priorities in favour of costly, luxury

apartments and distorts land use pattern.

Since production and consumption in the services sector are instantaneous, making detection difficult, the black economy gives a boost to the growth of services meant for the black income holders. It also helps mushroom many newer service occupations like those of agents, touts, brokers, income tax advisers, musclemen, lumpen political operators masquerading as social workers and 'artists'. In general, these factors increase the weight of the tertiary sector in the economy, tilting the balance against material production.

The growing size of the black sector limits the possibilities of increasing public investment and thus weakens planning. Similarly, the fact of the existence of undeclared incomes and savings limits the effectiveness of monetary, credit, licensing and other public policies. Diversion of black resources into non-taxed or lightly taxed areas like agriculture and orchard, etc, leads to their ineffective use, since they are mainly speculative uses of black savings.

It is shown that it is naive to suppose that holdings of black money can provide some sort of cushion against deficit financing. The continued operation of a sizeable black sector tends to push up the expected rates of return on investments and hence works against industrial investments, innovations and R & D

Not only the black sector works against fuller employment and self-reliance, but in so far as the dominant economic interests are enabled to increasingly intervene in the political sphere, they succeed in bending the politico-economic processes to serve their sectional interests. Thus the black economy not only frustrates controls, but by accentuating the socio-economic problems, enhances the overt need for still more stringent controls, doomed to failure through the very same processes which necessitate such controls in the first instance. Thus the black-economy makes controls and regulation counter-productive.

The use of the black incomes and assets for buying political and administrative patronage leads to weakening of controls, leaving loopholes for evasion. In general,

increased political power of the black sector brings about a symbiosis between business and government leading to a growing divorce of declared policy objectives from actually achieved outcomes. Thus, a good deal of what are called "implementation failures" are a systematic departure form the stated aims engineered, among other factors, by the use of the power of the black sector. Thus, we consider it a reversal of causality (if something like causality can be established in social affairs) to consider the black economy a consequence of economic controls. Rather, the black economy, arising from more basic factors, not only frustrates controls but also necessitates further controls, which have very slim chances of effective implementation. It is suprising indeed that the recognition of a vast black sector and pleas for removing/reducing controls can be made in the same breath, because, this implies either that the black sector can be controlled, if not eliminated without public controls and regulations i.e., black sector will commit harakiri of its own in the glorious laissez-faire tradition or that one may well accept its existence along with all its consequences.

Our discussion of the operation and consequences of the black economy suggests that it is a means to reconcile some of the apparent oddities and cotradiction inherent in a highly differentiated and oligopolistic economic structure with a Parliamentary, adult franchise based political democracy. This has made the Indian 'development' experience greatly derive from and contribute significantly to the phenomenon of black economy making growth anti- developmental and bringing about a worrysome degree of lumpenisation of the system.

The symbiotic relation between the state and business arising, inter alia through and in connection with the black economy, is well illustrated by an examination of various policy measures dealing with the black sector. We have examined in detail various demonatisations, voluntary disclosures and other administrative and legal measures to show that their conception, design and implementation were so defective and weak that it puts a question mark on the real intentions concerning the black economy. Despite these relationships, it is our contention that on account of sectorally uneveuly distributed control

over black resources (which distrub intra-class and inter sectoral balance of forces), particularly in favour of merchant capital, set back to rational economic calculations, inflationary destablisation of the economy, worsening scenario of absolute poverty caused by distortions in the real sphere caused by black deals, the external imbalances accentnating consequences of the black economy (helping individual holders of illegal foreign exchange but causing disturbing macro-level consequences), worsening fiscal crisis of the government on account of black sector leakages, the state finds it necessary to move against the black sector, albcit in a limited way.

A large number of more directly political factors (like greater collaboration between some black operators and certain specific political groups and parties), a certain sense of moral shock and emergence of specific political struggles against the black sector and its manifestations also account for various steps to control the black sector.

A policy package to deal with the black sector has to do one or more of the following: unearth and destory black incomes and assets, eliminate activities generating

it; bring about long run changes in the economic structure to prevent generation of black incomes; reduce or remove dealings in past black savings and wealth and also to bring out and channelise the black savings into areas of high social priority.

A large number of measures suggested by official committees and experts as also non-official agencies for dealing with the black sector remain unimplemented. This factor, along with the scheme of special Bearer Bonds, which serves no purpose in dealing with the black economy except giving a further boost to it, just as it produces the cosmetic effect of keeping down budgetary deficits go to indicate that a new high has been reached in the process of mutual accommodation between business with sizeable role in the black sector and the government. An effective policy response to the black sector is yet to be seen.

The basic constraint operating on public policies in effectively dealing with the black sector (which leaves this sector as an inevitable but marginal phenomenon, rather than assuming presently obtaining systemic pro-

portions) is the fact that the government and private business sector with black deals have become each other's benefactors as well as beneficiaries. To an extent, such a development is inherent in a polity which attempts to operationalise a theory of state and political development which treats the State as an autonomous component of the system acting as the guardian of general social interest. Contrary to the assumptions behind the model of the polity, the black economy not only turned out to be fairly uncontrollable but also started exercising some forms of control on the economy, politics and policies. The very intimate and dangerous intermingling of the so-called solution agent with the problem framework which has evolved during this period is a serious challenge necessitating structural solutions in the economic as well as the political spheres.

The intermingling of the unaccounted and accounted activities and transactions and the large and growing role assigned to the private sector with indirect and direct State support makes it difficult to indentify the areas which are to be restricted and curbed. Also it becomes very

difficult to promote the expansion of legitimate economic activities by curbing the black activities when the former is tied in innumerable knots with the unaccountable activities. Thus some of the constraints limiting the desire and need for curbing the black economy arise from its objective economic character in so far as the Indian Private Sector is concerned. For the private sector, the black component of it has become an indispensable component of it. The growth of the economy and the private sector entails the growth of the black economy as well. Thus clamping down on the black sector may at least in the short run, hamper 'growth', for whatever it is worth, including limiting the growth of the market.

Since data on the volume and depth of the unaccounted sphere of economic activities are difficult to be obtained, it becomes difficult to incorporate it within the formal models of the legal economy. Thus absence of adequate knowledge about the black sector acts as a constraint on the policy processes of dealing with the black incomes. The rigid, ideological conception of the Indian mixed economy limits the possibilities of doing away with the black sector. Changing property relations in certain areas and to a certain extent and transfering control over property

from private to public hands in some important sectors/ industries/activities are quite naturally policy choices of the last resort and has been used to a limited extent only for Indian economic policy to control the disease of black economy.

Since curtailment of black economy brings about many consequences to the economy which are in conflict with the preferred choice parameters, the drive for eradicting black economy cannot be taken up very effectively. Only a limited effort to keep it within manageable dimensions is likely to be made during periods when its size, distribution and mischief tends to threaten the balance of forces in a destabilising manner. We have argued that in pointing out the limitations on the possibilities of controlling/ eliminating the black economy, it is not a fundamentalist position concerning private enterprise. Rather the conclusion is based on the specific circumstances obtaining in in India.

The pursuit of profits and expanded reproduction in metropolitan capitalist development, in which competitive

Schumpetarian processes of creative destruction operated, produced larger employment, increased production of mass consumption goods, increased labour productivity and rising standards of living. Thus, it is very rare to find in these countries a black economy approaching Indian magnitude and menace; However, such a 'social dual' has not yet been observed in India and the black sector is large and powerful enough to obstruct the prospects of such a dual. Thus, despite the hue and cry about the black sector, its role in the system and its power put certain sharply identifiable limits on various efforts meant to curb it. Though elimination of black sector cannot be an acceptable objective, the inherent tendency for the self-expansion of black incomes and wealth produces various kinds of pressures to bring it under some control and put a certain amount of control on its operations.

It will be worthwhile to mention that the extent of the black incomes (simple, compound and political) can be reduced by taking several measures, like introduction and proper implementation of policies, programmes and laws, administrative steps, change in the political and constitutional structure and through those changes in politics which bring the masses increasingly into politics.

Considering limited state intervention for limiting the scale and intensity of the black sector politically possible and desirable, and economically feasible, poses the problem of evolving an appropriate of policy framework consisting of an integrated policy-package connected with the major areas of public interventions, taking a close look at the rationality, contents, form, methods and internal consistency of the total control sphere, i.e. economic planning, policies and administration.

The search for such a policy framework is confronted by a facile and simplistic view which puts the blame for the black sector on the very extitence of controls. This view identifies market outcomes with "efficiency" in a tautological manner; such outcomes are "efficient" because the market has brought them about. Obviously, this view either accepts market outcomes or considers them capable of self-correction through some equilibrating process a l a elementry economics tax-books. Even if the penumbra of disapprobation imposed by certain controls is removed, such activities and resulting simple and compund black incomes, giving rise to the black economy, will continue their self-expansion, probably at a faster

pace because now they are legitimate. In brief, it is the inability to scientifically evolve and effectively enforce the intent of the controls which breeds the black economy.

Apart from the pleas for such simple revival of the Smithian "invisible hand", there are others who recognise the need for controls, but argue against physical controls. They are for controls which operate through the price mechanism i.e., for making socially desirable economic activities privately profitable and socially unacceptable activities privately unattractive. Whatever tax evasion survives, must be, according to them, dealt with severely and still intractable marginal amount must be accepted as an inevitable price of the choices made.

It is apparent that serious structural imbalances cannot be dealt with through tinkering with prices, profits, etc. It is wellknow how the developed market economies have to go beyond indirect controls to secure many pressing socio-economic objectives. It is not that Keynesianism that has failed because of multiplicity and non-workability of controls and regulations; on the contrary the inadequecy, internal inconsistency and more

basic contradictions of the system are imparing their efficacy. In any case, the so-called supply-side economics is meeting its waterloo even in its initial phases and is so recognised even by its adherents, as the admission by an economic adviser to President Reagan of the USA indicates.

In a developing country the limitations of such indirect controls are well-recognised, necessitating overall, multi-level economic planning, a large and growing public sector, ensuring, among other things, a capacity to the government to control private decision-making and operations, control over physical, financial and social infrastructure and direct methods of ensuring essential supplies to the massas. Even the expansion of the market and its growing scope have to be catalysed by the State. The resource rasing implications of such a role of the State and ensuring viability in the international economy argue the limitations of indirect controls and put the case for a consistent, powerful and comprehensive set of controls adequate to the situation necessitating them in a bold relief. A secondary malady, i.e. the blake economy, cannot be made a pretext for doing away with controls designed to deal with the primary maladies afflicting the system. The question is not one of More <u>or</u> less controls; it is one of effective, adequate and internally consistent controls and resolution of political conflicts over the <u>sharing</u> of the costs and benefits of controls.

A specific varient of the above arguments is one which relates black incomes and tax evasion to high rates of taxation. According to this argument, either high rates of taxation causes black incomes because people do not wish to pay such huge sums in taxes, or the highly progressive tax rates make it more attractive and worth-while to tax-payers to evade/avoid it in terms of the gain that can be had by not paying it. Thus, it is argued that at higher rates of taxation, prospects of greater gains induce greater propensity to evade. The amount of tax evasion rises at least proportionately to or more than that with rising tax rates. However, if one reduces the tax rates, it is contended, one reduces the gains from tax-evasion. Hence the policy package for dealing with black incomes should include reducing the marginal rates of taxes.

The above argument would make sense, given its own logic and economic rationality, if it were also assumed that there are only gains to be had from tax-evasion and it is either a 'costless' operation or its 'costs' are

always less than 'benefits' and are furthermore either independent of the size of the operation tax-evasion or vary inversely with the latter.

The total 'cost' of evasion, in terms of conceatment of black income, holding it and avoiding detection, may vary depending on the behaviour and relative importance of these cost components. A symbiotic relationship between the black sector and the political system, which generates a high degree of tolerance towards the black economy, might help the operators of the black economy to keep a considerable margin(in terms of 'benefits' by evading taxes) over 'costs', in doing so, even at low rates of taxes. There will be little reason to expand the tax-base in response to lower tax-rates because, given relatively low costs involved in operating in the black economy, one would compare that which is payable with the alternative of not paying. The benefits of tax evasion are relevant only in relation to costs of evasion and, in the face of low costs, as is the case in India, which are viitually negligible even at low tax-rates, there is likely to be substantial tax-evasion in a relative sense.

That is to say given low costs of tax-evasion, high level of tolerance of it, the skills at tax-evasion and easy and plentiful availability of devices for the purpose, the gains to be compared by paying or evading taxes would only remotely relate to the rate of taxation. Given the insignificance of the cost of tax-evasion, the relevant comparison, at almost all practical tax-slabs and tax-rates, is between the volume of tax-payment and its "saving" if the tax is successfully evaded:

Contrary to the views of many other expert committes, the Direct Taxes Enquiry Committee, held that high marginal tax rates are a powerful contributory factor towards evasion of taxes. Thus, if higher tax-rates were leading to more tax evasion, then, leaving aside a probable bad conscience and the costs of efforts at tax-evasion, generally, the higher income groups should end up with being better off with higher tax rates than they would be with lower tax-rates! If such is the case one wonders why the high income groups campaign so hard for lower tax-tax-rates. More particularly so, if lower tax-rates were to lead to higher tax revenue, which may mean lower post-tax incomes, to the tax-payers, though not necessarily if the incentive

effects are positive. It is illogical to mix-up incentive effects of lower tax rates with their alleged anti-evasion effects and the former are by no means certain and unambiguous. The importance given to high tax-rates in the aetiology of black incomes, it seems, is disproportionate, misleading and perhaps motivated, particularly from the point of view of relegating other, more effective factors to the background.

Controls and taxation are necessary to curb certain activities in the economy. They themselves by no means create or help black economy. It is illogical to hold the laws governing economic activities themselves as constituting the reasons why people violate or evade the laws. From the social point of view there may be an impeccable case for the enactment and enforcement of certain laws and controls, yet there may be strong forces operating at an individual level for their evasion or violation and this fact, by itself, may make enforcement a tame affair, particularly if the interaction of the individual level forces constitutes a strong social force.

In the Indian context, the symbiotic relation between politics and black economy makes many laws concerning economic regulation, controls and taxation, nearly a dead

letter, it also enfeebles the machinery for their enforcement and implementation. As a result, the actual outcomes of the economic processes is sharply at a variance from those intended by the stated policy framework. If such a situation is not found acceptable and is intended to be changed, there are two major options: either to whittle down controls and taxation to bring them in conformity with what the market forces tolerate, and allow in actuality;
be give up the objectives market Processes cannot sustain,
or, to bring about some changes in the scope, intensity and power of market forces so that they become responsive and amenable to public control. Leaving aside these, the scope of the intermediate arena for increasing effectiveness and reducing the wide chasm between the social and individual perspectives is limited, through not altogether absent as the'fundamentalists presume.

However, this intermediate arena, which includes more effective implementation and sharpening and redefintion of controls and tax laws, have still some scope because (1) they have not been tried on a large scale, and (2) it retains the core of the long-term social perspective and helps in the realization of it. A fairly comprehensive set of measures, within these parameters, through sustained and successful implementation brings about some long-run forces and

processes cabable of giving a better fit between the social and market perspectives, or alternatively help change the character of the State in a small and cumulative manner, through may not by itself cause the qualitiative break.

Therefore, the "remove controls-reduce taxation" arguments are not tenable, nor is the 'fundamentalist' reliance on non-economic measures for changing the character of the state as a pre-condition a meaniryful proposition.

Any scheme of public intervention will comprise objectives (short and long-run or tectical and strategic), control variables, instrument variables, objects of control and agencies, sub-agencies and mechanisms of control. This comprehensive scheme relates in various ways to a large number of variables, processes and institutions in the economy. The success of any policy-design, which takes into account the above five elements, will depend upon

the understanding of the relationship that these five elements have have with the various other elements in the rest of the economy. If it is found that there is divergence between what the policies were intended to do and what they have actually done, then one can say that the policy-design is defective and the policy-design needs modification to yield the desired results. An analysis of this kind indicates the possibilities of successfully adopting various controls, the extent to which various

processes are controllable and the specific changes in the policy design in order to give it a direction and a thrust.

Such a scrutiny of various already instituted and intended policy measures may show that simply on account of the social and political pressures for a certain set of objectives, their institution by itself cannot ensure their success. The compatibility of various interventions with the general processes operating in the economy and the general role of the objects of control must be examined.

For instance, very high marginal rates of taxation may be required on account of the objective of equity or for financing public investment. But it may acts as a disincentive to private savings and investments. Such tax rates can curb present high incomes, provided the future avenues for the use of such incomes and savings are blocked. It implies not only a redefinition of the role of private savings and investment, but also effective expenditure, wealth and inheritence tax in order to blunt the will to evade and block the avenues for the use and multiplication of undeclared incomes. If private savings and investments can be, and are sought to be, encouraged, without any

ceiling and one can undertake any level of expenditure, then one provides every conceivable incentive for the defeat of the high marginal tax-rates, in fact, if the impact on such processes on the political processes are taken into accounts it becomes clear that such high marginal rates of taxation are tolerated mainly because they are non-operative.

A realistic dual test of making the controls internally consistent and externally strong enough to counter the general tendencies built into the system is an essential precondition for a significant reduction in the size and significance of black operations.

The design and effectively implement policy measures to control the illegal, undeclared economic activities one should know the various forms in which black incomes are held and the peculiar feed back relationship between stocks and flows of the black income.

Black wealth is not only kept for speculative and security motives but also for income and transactions motives. Thus, the switchover from goods into cash and vice

versa increases the velocity of circulation of the cash counterpart of the black income. Another form of liquid black income can be found in the form of deposits in the banks in various unscrupulous ways. In addition to these visible financial assets held in cash form, there exists a certain amount of money which is used in the black markets for real estate and bullion.

The constant, swift floating of money in the black economy brings forward the need of demonetisation of higher denomination currency notes as a means for unearthing as well as cancelling out a good part of black incomes. The penal demonetisation move not only causes a good deal of loss to the liquid black funds but also leads to curtailment of many compound black income operations. Thus the impact on the economy will be through a sum which will be multiple of the amount cancelled as a result of demonestisation.

However, it should be pointed out that, to the extent "the holders of black wealth are unlikely to come forward and present any significant part of their currency holdings for conversion" the policy of demonetisation is successful. And the greater the impounding of the stock, the greater is the curtailment of future flows emanating from these stocks. In addition to these, there is another advantage of demonetisation of high denomination currency notes (Rs. 100 and Rs. 50 notes). Presentation of black money for conversion attracts the attention of income tax administration. Thus, knocking out the stocks of black wealth also reduces important sources for generating the flow of black incomes. There is hardly any other equally potent instrument which can knock out such a good deal of black wealth"in one blow.

In addition, a periodic recourse to demonetisation will go a long-way, through its penal, deterrent effect, to bring about a downward adjustment in the acceptable rates of return from savings, enterprise and high-proficiency work. This would weaken the tendency towards tax-evasion and unaccounted activities. However, it must be admitted that the step of demonetisation would entail

some administrative costs and hardships and inconvenience to honest tax payers and ordinary citizens; besides some leakages may reduce its effectiveness. While one may plead for minimisation of the costs, inconvenience and leakages, there is little else which is possible under the circumstances.

So far the Government have given much more preference to other inherently ineffective schemes to unearth black money than to the policy of demonetisation. This is so because of the growing symbiotic relationship between the State and the lumpen capitalist classes. Through some other schemes like voluntary disclosures or Special Bearer Bonds, the Government have helped the black economy to grow further via rewards for dishonesty. Of special importance is the Special Bearer Bonds Scheme, because it marks a stage of a very high order of mutual accomodation and symbiosis between the State and business in India.

Concealment of black income in the form of investment in real estate is a very common practice. Over and above the ease with which investments can be made, concealed, under/overstated and kept out of the network of taxation,

they also tend to give good financial returns in the form of rental income, capital gains through appreciation, etc, which escape tax-net in one way or the other. Thus, in India, an index of the growth of the black economy can be found in the form of sky-rocketing prices of urban real estates.

Methods of unearthing and penalising black wealth in real esta-te must includ methods which can produce one ore more of the following results: (control variables)

(1) detection of real estate held in fictitious names,

(2) declaration of the correct sale price or cost of construction of houses, building and flats,

(3) declaration of the actual rent received on real estate and prevention of 'pugree' payments in order to evade taxes.

(4) discourage sinking of huge sums of black incomes and wealth in luxury housebuilding or buying in order to use past black wealth and evaded taxes,

(5) prevention of speculative deals in real estates,

(6) reduction of the attractiveness of real estate as a form for holding stocks of black wealth so that such resources come into the open and are used according to social priorities.

No single measure can yield the wide sweep of the expected results. The Direct Taxes Enquiry Committee suggested, among other things, the acquisition of those immovable properties whose sale deeds do not reflect their fair market price or where the costs of construction are understated. The first recommendation has been implemented by the Taxation Laws (Amendment) Act, 1972. It appears, from facts, that this provision is mainly in the form of a threat against under-registration of values which has not actually been carried out to any reckonable extent.

Recently it was suggested that the intentions behind the measure may be realised if the right to enter into transactions in immovable property is nationalised, without involving transfer of property to the State. Thus, the public agency, it appears, would be a kind of broker and presumable though not necessarily, meet its costs by charging such a brokerage. It should be pointed out that leaving out the question of the pricing principle and procedure adds an unwarranted degree of vagueness to the proposal. By taking over the right to sale and choice of buyers and implicity, the term of

sale, the right to own and hold property is also significantly eroded. The political pre-conditions for making such a move are not vastly different from those of involved in nationalisation of such properties. The feasibility of the proposed remedy on political grounds does not seem to be meaningfully different from that associated with ceilings, etc.

More important are the questions of administrative feasibility and the impact on the econo-my. Its implementation will open floodgates for political-administrative black 'incomes'. Even if the suggestion was successfully implemented, it will tend to discourage the future conversion of black wealth into real estate and future speculative dealings; without being able to touch past deals of this kind.

An alternative which can better meet the desired ends, in so far as any single step of a policy-mix can, is to ensure that the right to compulsorily purchase properties at their understated purchase price or construction costs is effectively carried out. This, of course, will not succeed, as has happened in India,

in the absence of any effective machinery, resources and specified modus operandi. If a public sector Real Estate Corporation, or a number of such Corporations in different tax administration zones, are established and, given resources, entrusted with the task of mandatory purchase of undervalued properties, a greater deal of dent can be made in the menace of the black wealth in so far as it has taken and takes the form of real estate.

The scope of activities of these Real Estate Corporations can be determined in one of the two ways. If past uses of black wealths are to be penalised and destroyed and an effective move against the black economy and its expansion is to be made, the corporations may be entrusted with all the undervalued properties bought up by the Tax authorities over a period of, say, past ten years. But if the sights are set mainly on the present and future, then the coverage of the corporations may be confined to cover properties registered or built during the past two or three years or for the period for which tax assessments are to be made or are open for assessment.

Apart from killing black incomes and wealth invested in real estate, the above move is bound to be deterrant and thus close one important avenue for the use and reproduction of black incomes. <u>To enhance its effectiveness, it may be essential to restrict the legal provisions concerning the right to transfer use by means of granting power of attorney used for comouflaging sales of real estate</u>.

Similarly, the <u>real estate corporation</u> can bring about sea-change in the market for lands and buildings by means of weakening the motive of speculative demand for these assets. As a result, the rise in prices of these assets is likely to become moderate. The social consequences of such a move are, therefore, self-evidently desirable. To increase the effectiveness of the measure, a ceiling on an all-India basis on the total value of urban estates can also be enforced.

In fine, the propsed scheme offers scope for variations over time and over different places; it is not a rigid scheme.

The proposed mandatory purchase of undervalued real estate by a public corporation along with demonetisation of high denomination currency notes can go a long way to enearth, destroy, and stop regeneration of black incomes and wealth. In sum, for the present these two basic steps can go as far as is politically and administratively feasible in the prevailing set up.

A number of legal and administrative measures might also help in dealing with black incomes. People with black wealth use the banking system not only to conceal black income in a safe and fictitious way but also to earn a fair amount in the form of interest. In addition, the funds with the banks also possess a good degree of liquidity.

To cope with this type of activity what is required, in addition to making payment on maturity by crossed cheques compulsory, intensification of seizures and searches, is computerisation of information regarding bank accounts both on regional and central basis above a specified level and their cross checking against computerised tax returns. To help this process, the

permanent income tax account numbers will have to be supplemented with Central Taxes Pass-Books, which will carry every detail about one's assessed income, source of income, major items of wealth, entries about gifts made or received, bank accounts with periodic closing balances, fixed deposits with maturity dates, deals like investment in real estate, plants and machinery, purchase of shares and debentures, borrowings and lednings, etc.

The case for these Pass Books will be greatly enhanced if the recommendations of the Direct Taxes Enquiry Committee regarding evasion of taxes are implemented properly. For instance, combined tax-returns for income, wealth, gift and estate duty will help a proper assessment and cross-checking for authenticity.

The recommendations of the DTEC, some of which require further study and strengthening in order to produce desired results, if implemented properly, will initiate a clear cutprocess of an offensive against existing black wealth as well as the processes of its continued generation.

Some additional measures are suggested to supplement the steps suggested by the DTEC.

The existing controls and regulation on the Indian corporate sector are not sufficient. Auditing of the accounts in this sectory by independent and impartial agencies is an important means to exercise control over this sector. According to the DTAEC, ARC's Working Group and the DTEC, compulsory audit must be extended to cover non-corporate business or professions. But compulsory autiting by the present professional auditors will not lead to much appreciable reduction in the scope for tax avoidance/evasion. One of the reason of this is that there are enough *a priori* grounds to expect the auditors, who themselves evade taxes, to be in league with the tax evaders in the non-corporate sector. If auditors are to detect concealment and manipulation and prescribe forms for maintaining and scrutiny of accounts, then a different concept of audit and its nationalisation are essential preconditions for it. This thing is yet to be experimented with.

Improvements in tax laws and their administration can also play a useful role to curb the production and proliferation of black incomes. Various tax laws contain provisions for prosecution of the tax offenders, but the relationships between the politicians and the tax offenders does help in not implementing these properly. This has been observed in India. It is recommended that if there is any solid evidence of tax evasion in any case, then the enforcement agencies must conduct searches without any unauthorised, informal discussions with the political leadership concerning ordering of searches and seizures. The Ministers should not be allowed to prevent any searches, though he may initiate such searches. A periodic review and public statement of the reasons for unsuccessful searches and statement of reasons for not proceeding with prosecution can also be helpful in strengthening this measure.

Another measure mentioned in the income tax Rules requires taxpayers to indicate major items of expenditure which could lead to unearthing of black expenditure which arises from tax-evasion, was not operationalised and later on completely given up due to active opposition and lobbying by interested parties.

The above measures, acting and interacting in many ways, will improve the anti-tax-evasion potential of the tax administration. These steps will also contribute to building up of the morale of the actual man on-the-spot of go ahead with his duties without much risk of being fettered by political interference in preventing anti-evasion action.

Given the basic limitations of policies designed to curb and curtail the black economy in the short run, attention is turned to the long-run perspective for effectively marginalising the phenomenon of the black economy. These measures and policies simultaneously serve a wider set of basic policy objectives.

There is need to redefine the relative roles of public and private sectors with a view to weaken the correlation between general economic expansion which occurs, of necessity, mainly in the private sector and the expansion of the black sector. Though expansion of the public sector does not amount *ipso facto* to a reduction in the scope for generation of black incomes,

there is obviously lesser scope for the black sector to grow. This is so, because there is hardly any scope and motivation for the creation of simple black incomes. Normally it is the simple black incomes which provide the main sustenance to compound black incomes. To the extent, there are administrative-political black incomes in the hands of the managers and decision-makers in the public sector, there may be some limited generation of compound black incomes. However, the basic motivation arising from the divergence between acceptable and post-tax actual returns does not apply to public sector functioning.

The history of public sector in India tells us that the public sector has grown in terms of the considerations arising from the strategy of development enunciated in the Five-Year Plans, the structural gaps in the economy, the industrial policy resolution and the pressures of various kinds arising in the political sphere, most importantly the lobbying and pressures from big capital and international financial agencies. By about late sixties when the Indian public sector

overcame the basic weaknesses that a newly developing underdeveloped country faces, the stance of the private sector with respect to the role of the public sector began to change. The Indian private sector and their foreign counterparts, who have never looked kindly to the policies of expansion of public sector in India, established a new type of relationship whose basic point was to creat obstruction against the expansion, diversification and strengthening of the public sector.

Such limits on the growth and functioning of the public sector were expected to lead to increased scope for the expansion and strengthening of big private capital as well as international capital in the form of MNCs. Thus, shortage of capital for the growth of the public sector, particularly in the field of heavy and basic capital goods industries, along with the growth of black money led to a slow-down in the growth of the public sector. The efficiency of economic controls and regulation became limited because the State could not muster strength to bring about other supplementary changes in the economy over a longer period, which are essential to supplement the policy aims sought to be

achieved through short-run economic regulations and controls. Various kinds of shortages and distortions, actual or anticipated, impelled the Government to institute various controls which delimitted, prohibitted, modified or redirected private decision-making in various ways. The operations of controls led to fettering of the incentives which were offered for the expansion of private industry.

The only effective way to deal with recurring short-run shortages is to make a big public entry in these areas and go in for a realistic price policy designed to ensure good returns for the expanded public sector output. In other words, controls initiated in order to meet shortages need to be supplemented by adequate public investment in order to meet the shortage and eliminate the need for the continuation of controls. As far as non-essential goods are concerned, the market response to shortages need not be interfered with and market correctives may be relied upon to meet the shortages. But in the case of essential or social priority goods, controls will have to be imposed and supplemented by direct action. Such an operational 'stick' will

galvanise private enterprise to avail of the "carrots" of incentives and support, and desist from thriving on recurring shortages under the threat of losing the activity out to the public sector. Public sector must take-over the production of priority goods like mass-consumption goods and wage-goods, because this will not only plug one source of black income but also it will help fighting inflation, generate additional employment opportunities, and help redistributioning of income in an egalitarian manner. Since the existing highly skewed distribution of income puts severe limits on the size of the domestic market for mass consumption goods, not much private investment is forthcoming for these goods. <u>In a way, it is the prior production of mass consumption goods with labour absoring technologies based on indigenous resource-endowment which will provide the market for these goods.</u> Thus the public investment in these goods will become viable and self-sustaining alongwith making a contribution to the process of development in the real sense of the term. This will generate a good deal of demand for the basic and capital goods industries of India's public sector which are

presently handicapped by unutilised capacity owing to inadequate demand. A fillip given to the basic, capital goods segment of the Indian Public Sector is likely to improve the quantum of surpluses generated in these industries.

The spread of industrial sickness may be slowed down by the competition provided by the public sector mass consumption goods industries. The role of the public sector in this area will impart it effective structural strength leading to countervailing role vis-a-vis monopolies.

The present public distribution system need to be extended to cover mass consumption goods and by taking it to wider areas in order to curb the role of private trade in these commodities. Extension of public sector in the form of public distribution system and state trading which will cover the bulk of foreign trade also, in important commodities is an effective step for curbing the scope for generation of black incomes and investment of black sector savings. The essential logic behind this policy is that there are inherent limits to the capacity of the Smithian "prudence" of the private enterprise to produce outcomes confirming to the Smithian social "beneficence".

Controls and regulation of private activities not only cannot go very far by themselves for a variety of reasons and might produce a series of inter-connected distortions in the economic and political spheres. Thus, for instance, high rates of taxation, which, in effect reduce the degree of privateness of private property, irk the private sector, at times, even to the extent of producing, what Musgrave calls, "Spite effects". To meet this challenge, a government must permit itself to enter the activity of directly undertaking the responsibility of producing those goods whose supplies are either persistently reduced or inadequately increased by the private sector. If any control and regulation is to succeed, the size, composition and nature of the public sector must of necessity be in conformity, among other considerations, with the severity and extent of control which the public system intends to impose on the private sector. The basic source of power is control over productive assets and surpluses and without an appropriate amount of such direct control, regulatory public policies will largely come to grief. Hence, an independent economic base provided by a flexible and dynamic concept of public sector is essential

in order to provide the necessary economic strength for carrying out economic controls and regulation.

The political preconditions for the acceptance of such a policy with respect to the public sector are hardly in evidence. This may be due to the hostility shown against this policy by both domestic and foreign capital. Hence presently the perspective concerning role of public sector is an issue for mobilisation and campaign, which may form a part of the campaigns launched against the black phenomenon.

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